

THE IMPLEMENTATION OF GASB 45

Case Studies of 15 Counties

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Unless otherwise stated, the opinions given in this report are those solely of the author and do not necessarily reflect those of the Center for the Study of Counties, the National Association of Counties, or NACo's members.

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The National Center for the Study of Counties is a focal point for the study of practical issues important to county government. It brings together research and outreach activities relating to counties, their governance, and public policy issues of significance to county governments not only in Georgia but nationwide. This initiative is the nation's first university-based center of its kind in the United States.



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EXECUTIVE SUMMARY

Generally speaking, governmental accounting standards do not receive much attention outside of the public finance and accounting community, even when the standards dramatically alter the presentation or the types of financial information available in governmental financial documents (e.g., GASB 34). *Statement 45: Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, more commonly known as GASB 45, is different. Rather than leaving implementation solely to accountants, county commissioners, executives, managers, and department directors are learning about and taking an active role in GASB 45 implementation. Why? Because GASB 45 is forcing governments across the country to learn the accumulated actuarial costs of their retiree health care and other postemployment benefits (i.e., OPEBs). Though knowledge is power, it can also be at times, shocking. To help prevent or alleviate the surprise or perplexity government officials may be feeling about GASB 45, this report 1) provides brief overviews on the major issues surrounding this statement and 2) profiles 15 counties from across the country that are in the midst of GASB 45 implementation so that others may learn how they are approaching the statement and retiree health benefits.

There are a myriad of complex ideas associated with GASB 45, including an appreciation of governmental accounting and finance, health insurance, and public outreach and communication. To fully develop and analyze all the points on any of these subjects would result in lengthy manuscripts, therefore this report introduces the topics through brief overviews that we hope will be of use to county commissioners and their management teams involved with GASB 45 implementation. Of course, department directors will have more information in their areas of expertise than provided in this report; however, we hope they might be able to learn about other issues beyond their daily purview. In order to give readers the opportunity to decide which topics are of greatest interest to them, the Executive Summary briefly describes the sections within the body of the report.

We begin the report with a background about the role of the Governmental Accounting Standards Board, and a summary of the accounting statement, its requirements, and the pros and cons of the statement itself. Next we briefly discuss the environment in which governments are implementing statement 45 such as challenges caused by Baby Boomers entering retirement.

After this overview, the report goes through the major steps in the GASB 45 implementation process. The steps themselves as well as advice from officials about starting the implementation process are introduced under *Getting Started*.

To comply with GASB 45, all governments will need to undertake an actuarial valuation of their OPEBs and thus this is where the process begins. As the title states, *Actuaries and Finding an Actuary* explains what an actuarial valuation actually entails followed by ideas for finding and working with a qualified actuary and procuring an actuarial valuation for a government's OPEBs.

Once a government learns its OPEB liabilities from the actuarial valuation, the government needs to develop an approach to complying with GASB 45. To help governments think about what would work best for them, the report discusses components of an implementation plan, including the implementation philosophies a government should consider, the types of persons that need to be consulted in implementation and timing for implementation.

The bulk of the report's Part I dedicates itself to introducing the major types of health insurance benefits available and simple tips for governments in keeping health insurance costs in check (see *Retiree Health Benefits and Controlling Liabilities*). This section seeks to promote discussion for government officials who are open to new approaches in health benefits for employees and retirees but are unfamiliar with what instruments are currently available. This chapter also offers suggestions from the Human Resource Directors interviewed for managing health insurance benefits including the benefits of creating a health benefit strategic plan and hiring a health benefits consultant.

The other side of the proverbial coin in managing OPEB liabilities is to figure out a means for funding them (see *Funding OPEB Liabilities*). This section discusses the ideas about means for funding a government's annually required contribution under GASB 45, funding policies, and benefits and limits to advance funding OPEB liabilities through long-term debt.

Government officials also need to understand how to manage the assets accumulated through implementation of GASB 45. *Managing OPEB Assets* focuses on the policy decisions that need to be addressed in this arena such as establishing a trust to deposit and invest monies to fund future OPEBs and creating investment policies that balance accountability and flexibility for money managers.

To the extent a county undertakes significant policy changes, like amending retiree health care benefits or issuing long-term debt to fund future OPEBs, public officials will need to discuss them with stakeholders. The kind of information and the method of communication varies by stakeholder as well. These methods and lessons learned from county officials about effectively sharing the county's policies are discussed under *Internal Communications, General Public, and External Communications*.

The final section in the first half of the report briefly addresses opportunities that external organizations have to assist counties in GASB 45 implementation. More specifically, the report highlights what some states are doing to assist local governments as well as suggests what state county associations can do for their members.

As stated previously, the second half the report profiles 15 counties and their progress in GASB 45 implementation. What one finds in reading about these counties is that their stories offer unique perspectives and lessons learned. To highlight these lessons, the profiles may focus on a particular aspect of implementation such as issuing long-term debt, inter-organizational agreements, or communication. We believe many readers will see aspects of their own county in reading the profiles and therefore, can learn ideas for improving implementation through these counties' experiences.

INTRODUCTION

Nationwide, county commissioners and staff are evaluating and changing how they think about retiree benefits. A new accounting rule enacted by the Governmental Accounting Standards Board entitled GASB 45 has spawned these efforts. GASB 45 creates new accounting standards for state and local governments in measuring, recognizing, and displaying post-employment benefits other than pensions (OPEBs) in their annual audited financial statements. The underlying principle is that these benefits are used by employers to attract and retain employees and therefore should be considered part of their total compensation package. More importantly, governments are now required to show accrued liability for OPEBs, meaning that they have liabilities not only for current OPEB expenditures, but also for benefits earned by employees who will retire at some point in the future. The critical issue facing governments is that many have not set aside revenues to fund future OPEB payments and thus they are facing significant liabilities on their balance sheets. This report explains and provides suggestions about managing the primary issues surrounding GASB 45. The information and advice is primarily drawn from interviews with elected officials and staff from counties who are in the midst of implementing GASB 45. We hope readers of this report will think about and be able to apply these ideas in their own counties as they implement the accounting statement.

As information about GASB 45 is learned, county commissioners, employees, retirees, and the public need to understand that the accounting statement did not create OPEB liabilities; rather the statement only requires governments to account for them. Through the statement, county commissioners will have a better appreciation of how their decisions on retiree health benefits and those of their predecessors have affected and will impact their county's budget not only next year but for decades to come. Ultimately then, GASB 45 is an information tool that commissioners, county

employees, and the public can use to gauge whether the government should adjust health benefit packages in respect to tax effort, programmatic demands, and the community's culture.

The report has two distinct parts: one that provides an overview of the major issues surrounding GASB 45 and another that tells the stories of 15 counties from across the country and their progress with GASB 45 implementation. After an explanation of the methodology, the report provides a brief explanation of GASB 45 which is meant for those persons who are not familiar with the statement's accounting terms and requirements. The report then offers a quick assessment of the environment in regard to retiree health care. The bulk of the report follows, outlining the steps to GASB 45 implementation. Through these steps, the major issues concerning the statement are introduced, including actuarial valuations, health-care benefit options, funding OPEB liabilities, managing OPEB assets, and communicating GASB 45 impacts to stakeholders. Following this overview, the report then offers the profiles of the 15 counties. Their stories are unique and each offers a different perspective about health benefits, funding, and communication. We hope the readers will be able to relate to these counties and learn ideas about what works (as well as what to avoid) when implementing the statement.

METHODOLOGY

Since the purpose of this report is to provide practical advice for counties implementing and about to implement GASB 45, NACo and the Center for the Study of Counties felt that interviews with county officials would offer greater insights than academic reports. Therefore, we selected 15 "first phase" counties from across the country and interviewed persons integral to the implementation process. They came from finance and budgeting, human resources, and central administration offices as well as the elected body. The counties were selected to maximize geographic and population diversity. Persons were interviewed either in person or over the phone.

To supplement the interviews, we also conducted a review of academic literature, of pronouncements from the Governmental Accounting Standards Board and the Government Finance Officers Association, and of presentations from private actuarial firms.



BACKGROUND:

Governmental Accounting Standards Board and Statement 45 (GASB 45)

The Governmental Accounting Standards Board (GASB) establishes standards of financial accounting and reporting for state and local governments and other governmental entities. The GASB is a private, independent organization created by the Financial Accounting Foundation (FAF) in 1984. The FAF establishes, administers, and oversees financial standards for all private sector organizations in the United States as well as state and local governments. The FAF selects the members of the GASB and strives to maintain the board's independence from political or economic influences.¹

Governments following GASB accounting standards are said to be following generally accepted accounting practices, or GAAP. These standards guide state and local governments in their preparation of external financial reports (i.e., financial audits). An external auditor would give an audit exception if a government's financial report did not fully adhere to GAAP. The financial report is an essential means of financial accountability to the public and serves as a decision tool for legislators and regulators who oversee a government's activities and for investors in government debt. Therefore, the standards, which are called statements, are designed to meet the information needs of the users of the financial reports.

SUMMARY OF GASB 45

The purpose of *Statement 45: Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* is the promotion of the financial accountability of governmental entities. As its title suggests, the statement focuses on non-pension benefits ("other post-employment benefits," or OPEBs) offered by govern-

ments to their retirees. It establishes standards for the measurement, recognition, and display of OPEB expenses/ expenditures and related liabilities and assets. Common OPEBs include dental benefits, life insurance, and health insurance, the most common and most expensive benefit. As part of a total compensation package offered to employees, OPEBs create liabilities for governments similar to pensions, in that employees receive the benefits during retirement. As baby boomers leave public service, these benefits will require increased funding, and taxpayers and lenders should have an accurate understanding of both present and future OPEB payments.

To comply with GASB 45, governments must account for OPEBs using an accrual basis of accounting rather than the pay-as-you-go basis (PAYGO) which has been the historical practice for nearly all state and local governments.² Under accrual accounting, a liability is recognized on the balance sheet when an exchange has occurred rather than when payment takes place. In this case, a liability must be recognized when a working employee earns an OPEB rather than when the benefit is paid, i.e., when paying a retiree's health insurance premium or insurance claim. PAYGO accounting in this area raised the concern that governments might accrue significant future OPEB liabilities by promising generous benefits to current employees. The true cost of these benefits might not be clear because payment would not occur for many years. Present-day knowledge of these future liabilities may be important to financers of government, such as taxpayers and creditors, as they assess the likelihood that these benefits will require tax increases or impede the repayment of debt. In contrast, governments that provide defined contribution benefits, like health savings accounts, are by definition fully funding liabilities as they occur, as in the case of 401(k) retirement plans.

To determine their OPEB liabilities, governments must obtain an actuarial valuation. To meet the GASB 45 standard, plans with two hundred or more current and future beneficiaries are required to have the valuation completed at least biennially; a triennial valuation is required for plans with fewer than two hundred beneficiaries. Plans with fewer than one hundred members may apply an alternative measurement method that allows the simplification of some assumptions; however, the basic premise of projecting future cash outlays for OPEBs remains the same. Because the vast majority of counties, including all of those studied for this report, do not qualify for the alternative method, it will not receive sustained attention here.

1 www.gasb.org and www.fasb.org

2 PAYGO expenditures are the current year's direct payments made by government, for liabilities such as insurance premiums and retiree health care claims.

The actuarial valuations are derived from a set of assumptions about the total current and future costs of retirement benefits, which are discounted to a present value. The valuation is similar to projecting the current liabilities of an employer paying an employee pension at a defined point in the future. This set of assumptions commonly includes estimates of the age and life span of retirees, the cost of medical claims by retirees and active employees, and the discount rate (the ratio that relates a future cash flow to its present value) among others. A key element in projecting health care costs is the level of benefit provided. In making these calculations, actuaries assume that the current health-care benefit will remain unchanged throughout an employee's retirement. Therefore, if a county changes its OPEBs or finds that some of its assumptions were inaccurate (e.g., retirees are living longer), its liabilities will change as well, and those changes will be reflected in its next actuarial valuation.

The actuarial valuation includes several key types of liabilities for which the government must have in order to comply with GASB 45. First, the valuation will calculate the *actuarial accrued liability* (AAL), which is the present value of future benefits attributable to prior years of service.³ That portion of the AAL which is unfunded is referred to as the UAAL. An OPEB UAAL can be thought of as the liability a government would owe if it had not set aside any money to fund employee defined-benefit pensions. GASB rules allow governments to amortize the AAL (i.e., prorate the liability) over a period of time that cannot exceed thirty years. The AAL and UAAL will be disclosed in the financial statement notes but will not be reported as liability in financial statements. However, Governments are required to measure and disclose OPEB liabilities that are equal to the employer's *annually required contribution* (ARC) to the retiree benefit plans with adjustments for the cumulative under- or overfunding in previous years. The ARC is composed of two parts: (1) *the normal cost for the year*, which in turn comprises two elements: (a) liabilities for current retirees (under PAYGO accounting) and (b) the present value of future benefits earned by active employees during that year, and (2) *the amortized portion of the AAL*. As governments fund current liabilities on an actuarial basis, this second component will disappear over time. In other words, if a government chooses to amortize its historic unfunded liabilities over thirty years and fully pays its ARC every year, after thirty years it will have fully funded its AAL and will not show that liability in its financial statements. Finally, governments are required to disclose descriptive information about each of their OPEB plans.

3 Public Financial Management, Inc. Presentation for Florida Government Finance Officers Association, November 13, 2006. www.fgfoa.org/files/OPEB_Presentation_111306_JimLink.ppt

GASB 45 requires counties to include explicit and implicit rate subsidies given to retirees in their OPEB liability assessment. Explicit subsidies involve the government directly paying a benefit, such as a percentage of a health insurance premium. Implicit subsidies are more ambiguous. "These subsidies arise when employers [i.e., governments] include both active and retired employees in the same health care plan in order to access larger scale economies and subsequently better premiums and other costs"⁴. The costs for retirees and younger active employees are pooled, and the government assesses an average premium rate for all health plan participants. Since retirees typically have more claims than active employees, medical coverage for retirees is more expensive. Therefore, assigning the average rate to retirees is a subsidy, particularly in the case of pre-Medicare retirees.⁵ Even if the employer requires the retiree to pay the full cost of an insurance premium, the retiree is still receiving a benefit, because including retirees in the pool requires the government to pay a higher average premium for active employees. If the retiree were to pay his or her "true" cost, it would probably be much higher than the average cost. For example, in 2007 Mecklenburg County's actuary calculated the average implicit-rate subsidy per retiree as \$3,206; the amount Mecklenburg County retirees pay for their insurance is thousands of dollars less than it actually costs.⁶ Because of this averaging, GASB requires governments to report the implicit-rate subsidy, or the difference between the actual health claim costs for retirees and the costs for active employees. The implicit-rate subsidy is calculated as part of the normal and amortized costs discussed above.

GASB also recommends that governments establish an irrevocable trust fund to deposit their ARC payments. A trust fund holds assets on behalf of another entity. In this case, the government would be holding assets in trust on behalf of the government's current and future retirees. If the trust is irrevocable, a government cannot spend the money in the fund for any purpose other than OPEBs. The primary benefit of an irrevocable trust is the ability to invest the deposited assets (e.g., ARC payments) and earn interest, just as a pension trust fund does. This interest will help to fund future OPEBs, potentially reducing future OPEB allocations from the annual operating budget. To learn more about OPEB trusts, including their benefits and limits, please refer to the OPEB Trust portion of the Findings section of this report.

4 Marlowe, Justin. *Much Ado about Nothing? The Size and Credit Quality Implications of Municipal Other Postemployment Benefit Liabilities*. Public Budgeting & Finance (2), 104–131.

5 Medicare pays the medical expenses of retirees. Some governments permit retirees to continue with their local health plan, but that plan is supplemental to Medicare. For those governments, the costs for Medicare retirees approximates that of active employees.

6 Mercer actuarial report for Mecklenburg County, October 19, 2006, p. 13.

Governments have been granted varying amounts of time to begin complying with GASB 45 based on their total annual revenues in the first fiscal year ending after June 15, 1999. Phase 1 governments, with total revenues over \$100 million, are currently in the process of implementing GASB 45 and will report OPEB liabilities in their FY 2008 financial reports. Phase 2 governments, with total revenues between \$10 million and \$100 million, are expected to implement GASB 45 in financial statements for periods beginning after December 15, 2007. Governments with less than \$10 million in total revenues have an additional year to implement the standard (i.e., for periods beginning after December 15, 2008).⁷

Pros and Cons of Compliance with GASB 45

The GASB as an organization has no authority to mandate government compliance with its standards. A government's incentive to meet the standard stems from the ways that users of financial information respond to the contents of its financial reports. Compliance with GASB standards is generally considered favorably by credit-rating companies. Some government officials are concerned that noncompliance may reflect negatively on their creditworthiness, lowering their credit rating and raising the interest rates they must pay when they borrow money.

However, most government officials are concerned about another question, one that arises from supplying OPEB liability information in their financial reports: How does the government plan to pay its annual OPEB liabilities? The process of hiring an actuary to estimate OPEB liabilities and providing that information in annual financial statements utilizes staff time and resources, but funding historical, current, and future OPEB liabilities, particularly for health care, is a source of much greater concern for many state and local governments.

Pros

The statement supports the values of good governance: transparency and accountability, fiscal responsibility, and long-term decision making. GASB 45 promotes transparency and accountability on the part of governments by requiring the full costs, short- and long-term, of OPEBs to be disclosed to taxpayers, elected officials, and credit-rating agencies. Since only a handful of governments had funded their OPEBs in advance or performed an actuarial valuation on these benefits, most officials lacked even approximations of their future cost. Similarly, taxpayers now have a better idea what their true burden will be. Lenders can also use this information when deciding whether a government will have sufficient resources available in the future to repay debt and is therefore a good credit risk.

The actuarial valuations required by GASB 45 provide an important information tool to government officials. Calculation of the costs of OPEBs has forced a discussion of governments' health-care benefits across the county. County commissioners and senior management are reviewing policy decisions and reevaluating the benefits that governments can afford to offer retirees. As an unbiased source of information, the actuarial reports can be also very useful for governments and labor unions in negotiating health benefits.

Finally, because the actuarial valuations focus on the long term, they encourage elected officials and senior management to do the same. By creating trusts, governments save for retiree health care as they would for pensions, a process which will protect taxpayers and retirees. GASB 45 prevents governments from being "surprised" by the cost of OPEBs as expenses incrementally increase and reduces the likelihood of sudden pressure to raise taxes, reduce benefits, or cut public programs. As one interviewee stated for this report, "GASB 45 shines a light on the issue (of OPEB costs) before bankrupting government." The standard helps protect programs and services by ensuring that governments have sufficient resources to fund them in addition to sustainable OPEBs.

Cons

Not all persons in government agree that the new standard is appropriate or that meeting all of the implied requirements (i.e., funding the ARC) is even necessary. Some argue that, since many counties retain the right to alter retiree benefits at any time, future liabilities should not be calculated assuming no change in benefits. Supporters of the standard respond by pointing out that the county's next valuation, required within two years, would reflect benefit adjustments through a new AAL. Moreover, most government officials want to provide health benefits to county retirees and would find it difficult morally as well as politically to dramatically reduce those benefits.

A second complaint is related to the inclusion of the implicit-rate subsidy in the valuation. By pooling current workers and retirees and by setting an average insurance premium rate for the entire pool, governments clearly subsidize the premiums of retirees, especially those who do not qualify for Medicare. Some governments contend that describing the implicit-rate subsidy as a liability is merely an accounting exercise because the retirees do not receive any form of direct payment. If this subsidy were a government's sole liability, the government could only eliminate it by setting aside funds to reimburse itself (or its health insurance fund). However, even though governments do not pay this benefit directly to retirees, implicit rate subsidies impose costs on government.

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7 Governmental Accounting Standards Board. *Status of Statement No. 45*.
www.gasb.org/st/status/gstst45.html

Some question whether actuaries can accurately project future retiree health costs. The underlying assumptions inevitably rest on predictions about the future, and the resulting uncertainty may cast doubt on the estimated accrued liabilities. One of these assumptions is the subject of particular criticism. While OPEB valuations rely on many of the same assumptions used for actuarial valuations of pensions, (e.g., discount rate, age of retirement, life span), an important difference between the two involves health care. These expenditures constitute the vast majority of OPEB liabilities for any government providing this defined benefit; however, health care expenditures can vary greatly. Unlike pensions, which promise a calculable dollar amount, future advancements in the health care industry may dramatically change the cost of providing this benefit and the resultant actuarial valuation. This concern may be somewhat exaggerated, since, as noted above, actuarial valuations will be completed every two years, and any changes in health care costs can be incorporated into them.

Others have complained that actuarial reports are inconsistent, demonstrating the inherent ambiguity of the work. However, studies have found that, when actuaries use the same set of assumptions, their valuations are fairly consistent. While this criticism may not be well founded, it raises an interesting point: Since governments retain some authority to choose some of their assumptions, with the discount rate being the most influential, a government can manipulate its AAL (actuarial accrued liability) and ARC (annually required contribution). However, a government that adopted an overly aggressive discount rate and then did not realize the expected high interest earnings, would find that its next OPEB (post-employment benefits other than pensions) valuation reflected an even larger liability.

A final issue that has arisen in the debate over GASB 45 is the cost of the ARC in relation to the cost associated with the disclosure of unfunded actuarial accrual liabilities on a balance sheet. Devoting money to the ARC means the government must either raise additional revenue or reduce spending elsewhere. Some government officials are not particularly worried about the potentially negative effects on their credit rating. Their government's credit rating may not decline, and if it does, the government may choose to purchase bond insurance, making a credit rating less important. This option may be particularly helpful to smaller governments who borrow money infrequently; bond insurance might well cost less than their ARC under GASB 45. However, a government's decision to fund the ARC or continue with PAYGO does not alter its actual OPEB liability. Only a change to the benefit itself would alter present and future liabilities.

The last sentence deserves further comment. A few officials interviewed for this report have commented that the implementation

deadline associated with GASB 45 may be creating an alarmist attitude. Government officials may feel extreme pressure to institute significant changes to their health benefits immediately in order to reduce or eliminate OPEB liabilities. However, OPEB liabilities represent health-care benefit policies for a government and deserve analysis and discussion by policy makers. Furthermore, many governments are either legally or politically precluded from making sudden and dramatic changes to their retiree health benefits. For governments that include OPEBs in union labor contracts, benefit modifications must be negotiated and therefore will evolve incrementally as contracts are renewed. Interest groups like unions and retiree associations can also assert significant influence on the policy-making process, encouraging maintenance of the status quo or increasing benefit levels. Competing pressures (maintaining the status quo versus reducing liabilities) have placed elected officials in a difficult position, requiring commitment, leadership, and additional education.

THE OPEB ENVIRONMENT

Health Care

Employers providing health benefits to employees and retirees face what can be called a harsh environment. Health care costs continue to rise well above the rate of inflation. For self-insured governments, increasingly higher claims means paying higher premiums for active employees (and perhaps retirees) to keep their insurance fund solvent. For governments that are insured (rather than self-insured), competition for an insurer is typically limited to one or two companies in their region. What a county could afford 25 years ago will almost undoubtedly be unaffordable today.

To combat rising health care costs, governments have been getting creative and more aggressive. Self-insured counties are demanding more from their administrators or simply bidding out the contract, trying to save on administrative costs. Counties are also rethinking and reworking the health packages they offer. Some changes are minor, such as raising co-pays or adding prescription discounts for generic drugs. More and more counties are offering wellness programs that range from health fairs to gym discounts to actual premium reductions for reaching health care goals. Other changes are structural in nature, such as moving to a defined- compensation plan for retiree health care by offering retiree health-savings accounts which are paid similarly to a pension 401K account. The key point is that local governments have realized that they cannot afford to be complacent with their health-care benefits.

Although the health benefit packages that governments provide retirees differ considerably, the counties studied for this report shared

a handful of similarities. For the purposes of brevity, these are highlighted below:

- Counties typically offer prescription drug coverage as part of their health-benefit plan
- Counties mandate some level of vesting for retiree health benefits, but the details for vesting differ substantially
- If a county provides health benefits to retirees eligible for Medicare, the benefit is only supplemental to the federal insurance plan. For several counties, this is a new provision.

Of course, any description of retiree health benefits must be viewed as only a snapshot in time. Governments regularly evaluate and amend their health coverage in their efforts to provide the greatest benefit within their financial constraints. Our report includes information about health insurance coverage for the counties in order to provide context for the actuarial accrued liability (AAL) and concomitant ARC.

Retiree Population

In addition to rising costs on a per retiree basis, several other factors have influenced retirement health care liabilities for counties. First, governments are beginning to face the baby boomer retirement surge. Counties in the study anticipate a relatively higher number of retirees for the next few years, with a leveling off after that. Some governments, like Gwinnett, experienced significant population growth in the late 1980s, with a concomitant number of new personnel. These employees are now ready for retirement. Other counties are bearing the impact of reduction-in-force and early-retirement policy decisions. Under PAYGO systems, the early retirement programs appear to save organizations operating dollars (e.g., salaries); however, with accrual accounting, governments now see just how expensive it is to provide these pre-Medicare health benefits for several additional years. Finally, persons are simply living longer, and even supplemental Medicare insurance costs governments money. A person born today has an average life expectancy of 78 years,⁸ which can literally mean decades of OPEBs funding for a government.

National health Insurance

Several interviewees mentioned the creation of a universal health care system as a very important issue in deciding how to implement GASB 45. Several presidential candidates have made the establishment of a universal health care system through federal legislation a campaign promise. For counties in their role as employers, national health care raises several important questions: Will employers directly provide health-care benefits? How will the system be funded? What role will counties play in providing health



insurance? With national health insurance, will counties need to provide retiree health benefits? If not, what will counties do with the assets placed in irrevocable OPEB trusts? These are very serious questions which have tremendous fiscal and legal consequences. No county wants to have millions of dollars sitting in a trust with no purpose. To address this concern, some counties are writing specific dissolution clauses into their trust language. Through this kind of exemption, a county would have access to OPEB assets and be able utilize those funds for other purposes if a national health care system were to become a reality and the trust were no longer needed. However, unless this policy is actually enacted, the disclaimer remains untested and its final authority unknown.

8 U.S. Center for Disease Control. 2007. National Vital Statistics Report. Washington, D.C. Vol. 55, No. 19.

IMPLEMENTING GASB 45 – ADVICE FROM THE TRENCHES

GETTING STARTED

Implementing GASB 45 can be addressed in two general ways: more narrowly by only implementing the accounting statement or more broadly by analyzing and perhaps changing OPEB policies, and establishing a funding and investment mechanisms to pay accrued liabilities. Obviously, the larger perspective would by necessity include the accounting requirements from GASB 45. Using the ideas and recommendations from our profiled counties, this report considers some accounting issues; however, the bulk of the report will focus on the broader policy issues because these are and will pose the greatest challenges to counties.

Timing

The most common piece of advice from county staff and commissioners was to start the implementation process early. The entire process requires a significant amount of time from staff and elected officials because the accounting rule has not only new technical components that must be learned and addressed but also policy impacts that require analyses and decision-making. Even in counties that do not anticipate major OPEB changes and/or have small liabilities not requiring complex financial instruments, financial staff will need to dedicate substantial time to learning about the statement and developing the actuarial report. Several financial directors specifically talked about the time it takes to gather such data as health insurance claims for the actuarial report. Even in counties where few policy decisions will be made, staff will still need to get an early start on the county's OPEB valuation.

Interviewees also recommended that financial and human resource staff and elected officials give themselves time to fully comprehend the actuarial valuation and evaluate any proposed benefit and funding alternatives. Staff need time to put together thoughtful policy alternatives and elected officials and senior management need time to educate themselves and then consider their OPEB options. To save some time, interviewees recommended “stealing from other local governments” in terms of learning from colleagues who have already implemented GASB 45. Once a decision on benefits or funding the ARC has been made, an early start can allow a government to ease into the change. For example, by instituting an insurance premium rate increase early, a government can incrementally adjust the rate over multiple years and avoid the sticker shock associated with one large increase.

Steps in Implementation

GASB 45 implementation can be understood as completing a series of steps. The first step in the GASB 45 implementation process is to obtain an actuarial valuation. A government must first know

what its liabilities are before officials can decide what they want to do and how they plan to achieve their goals. In either a narrow or broad implementation perspective, the valuation must be completed. Once done, the county must then decide on an implementation plan. In general terms, the plan answers the question, “what will the government do in regard to its AAL and ARC?” Depending on the plan, implementation will take two roads: no policy changes (a narrow implementation) or amending OPEBs, creating funding mechanisms, etc. (a complex implementation).

For a narrow implementation, financial staff will learn the mechanics of the statement and book the liability on the government's balance sheet. Staff should give themselves sufficient time to learn the accounting rules, asking help from their actuary, external auditor, and those colleagues who have already implemented the statement. The difficulties in implementing the statement as reported by financial staffs varied substantially, depending upon the complexity of the implementation (e.g., creating a special fiduciary fund for an OPEB trust, or allocating ARC payments and OPEB liabilities across governmental and proprietary funds, etc.). In addition to the suggestions above, one interviewee advised implementers to attend classes on GASB 45, to read GASB and GFOA⁹ pronouncements, and to read professional articles.

Deciding to place a new significant unfunded liability on a county's balance sheet is really more than a mere accounting exercise: it amounts to a policy decision in itself. Therefore, senior management should discuss GASB 45 and the implications of an unfunded liability with the county's elected officials. Furthermore, based on the level of liability, communication with the public, retirees, and employees about the statement and the county's liability may be necessary. If a high liability could eventually pose a funding problem (i.e., tax increase or decreased retiree benefits) or credit-rating problem for the county in the future, it is better for the government to present the information and the reasons for sustaining the liability rather than risking the misperception that the government has been concealing information and/or that it has betrayed its stakeholders. For ideas on effective communication techniques, please read the Communications Section of this report.

If a county decides on policy changes, such as amending OPEBs, raising revenue to fund the ARC, etc., additional implementation steps and a more developed plan will be needed. These additional steps include evaluating and perhaps adjusting benefit structures, analyzing impacts of OPEBs on the budget, establishing an ARC funding plan, and developing financial vehicles for OPEB assets (e.g., creating accounts or irrevocable trusts).

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Below is a summary of the steps for GASB 45 implementation¹⁰:

- Complete actuarial valuation
- Develop an implementation plan
 - Decide on implementation philosophy
 - Involve senior management and elected officials
 - Create inter-departmental partnerships
- Evaluate and amend OPEB policies
 - Decide on county's goal and philosophy for offering retiree benefits
 - Identify optimal structure for meeting goal
 - Approve benefit changes
- Decide on potential funding choices for the ARC and AAL
 - Study operating cash flows for meeting ARC liabilities
 - Make short- and long-term decisions for funding ARC revenue
 - Decide whether to advance-fund AAL (issue bonds)
- Decide how to manage OPEB assets
 - Create operating budget accounts, irrevocable trust
 - Create investment policies for asset management
 - Select asset manager

The following sections of this report delve more deeply into certain aspects of the above-listed steps. Ideas and recommendations come from the elected officials and staff interviewed as well as from professional material available from the internet. The comments that highlight specific areas are meant to foster discussion for readers rather than provide a specific guidebook for GASB 45 implementation.

ACTUARIES AND ACTUARIAL VALUATIONS

The first step in GASB 45 implementation involves hiring an actuary to perform a county's OPEB valuation. Nearly all the financial interviewees recommended getting the actuarial report completed as early as possible. The exceptions were those counties in which staff already knew that their OPEB liability was very small, either from their own OPEB estimates or because of the health plan structure, and so were not anticipating any policy changes. Having the valuation early is important because the information serves as foundation for all future decision-making on OPEBs. Because of its centrality as an information tool, the vast majority of counties profiled sought to be open and honest with their actuarial valuation, treating it like a public document.

The valuation itself is essentially a very complex math equation. The actuary calculates the accrued OPEB liability based on several factors, including the current health plan for a county (referred to as the substantive plan), data on employee and retiree demographics and health care insurance claims and premiums, the actuarial basis (i.e., assumptions), the projected future benefit cash flows (i.e., benefit payouts), and the discount rate.

Counties can move the actuarial review along by helping to collect the needed data. Demographic data can come from pension information, the health fund administrator, and county personnel records. As the customer for the health insurance claims administrator, a county has the right to insurance claim data and can insist on receiving it in a timely manner. One finance director found that collecting and organizing the demographic data helped her better understand the actuarial process and the reasons for the AAL (actuarial accrued liability). In addition, the county can ensure a better valuation by ensuring that the data provided to the actuary is as accurate as possible. From the calculated accrued liability, the actuary determines the unfunded portion, which is the liability less the funded portion, plus the normal cost, and the ARC (annually required contribution).

Interviewees generally had very good working relationships with their actuaries and found the valuation process very educational. Their relationships entailed a give and take in developing the valuation. Financial staff did not passively wait to see what the actuary would give them, but had a voice about all the inputs of the valuation including the county's health plan, the assumptions, discount rate, etc.

Both financial and human resource staff persons concur that understanding the assumptions of the actuarial valuation is crucial to comprehending the AAL and ARC. They point out that pension assumptions and OPEB assumptions are not the same, so knowledge of the former will not translate into understanding what is behind the OPEB AAL. From their experience, these staff members suggest that those beginning this process might find it helpful to read reports or attend training classes on governmental actuarial valuations. A county's external auditor might also serve as a resource, particularly for smaller counties whose staff might not have the time or the expertise to fully learn the nuances of the actuarial assumptions. To assist her, one finance director brought in her external auditor to review the assumptions used by the actuary.

Understanding the assumptions is so important because of their impact on the county's liability. When deciding on assumptions initially, a county should remember that changing them also alters the resulting liability. Therefore, to have comparable valuations over time, counties should try to keep consistent assumptions. By

10 Modified from Public Financial Management, Inc. Presentation for Florida Government Finance Officers Association, November 13, 2006. www.fgfoa.org/files/OPEB_Presentation_111306_JimLink.ppt

selecting the most appropriate assumptions the first time, a county can significantly reduce the confusion and the need for explanations to the elected body and the public about why liabilities are different from one valuation to the next.

Selecting a realistic discount rate is also beneficial in the long term. In the words of one interviewee, “Don’t ARC shop when selecting an actuary because ultimately, the government will have to pay the liability anyway.” Having an actuary choose an aggressive or high discount rate may be tempting in order to lower the AAL and ARC; however, if interest earnings do not match the discount rate, the next valuation will show a greater unfunded AAL and higher ARC. In sum, it is better to select a discount rate that conservatively matches the county’s historic interest earnings on investments.

Finding an Actuary

Three primary characteristics were mentioned by interviewees when asked what to look for in an actuary. First, all said that hiring someone with experience with GASB 45 was extremely important. With the vast majority of first-phase counties having completed their valuations, there are now several excellent firms across the country with this expertise. Furthermore, due to differences in state statutory requirements, it may be helpful to find an actuary who is knowledgeable about local government OPEBs and accounting requirements and about local and/or state health care insurance systems.

Second, the actuary should be a person who will work with county staff, giving advice and assistance throughout the implementation process. By having read and analyzed the health plan, the actuary should be able to work with finance and HR staff in creating workable scenarios. Furthermore, this person should give staff all the information they will need for the county’s financial reports. In other words the person should willingly listen to elected officials’ and staff’s thoughts about assumptions and scenarios but offer informed feedback as well.

Third, as part of that partnership, a county is best served by having an actuary with good communication skills. This should be a person who can clearly explain the valuation numbers, the assumptions behind them, and what they mean to the county. For example, the actuary should be able to explain clearly why various scenarios have such different impacts on the AAL and at what time period the greatest savings occur for each scenario (e.g., within 10 years, after 20 years). Furthermore, the actuary should be willing to present the valuation report to the county commission if asked and be able to do in a manner the clearly communicates the valuation’s assumptions and results.

The Contract

Interviewees offered several excellent suggestions for what to include in a contract with an actuary. First, many of counties profiled used one-year contracts with options for renewal. Because of the expense involved in learning about a county’s health plan, collecting data and the like, the first valuation will probably be the most expensive. Subsequent valuations will be far less demanding for the actuary and likely for the county. Furthermore, over time the actuary will come to better understand government operations and can improve his or her mathematical model. Finally, each actuary will create a slightly different model even if using the same data and assumptions. Therefore, keeping a good actuary over multiple years will improve the consistency of a county’s OPEB liabilities over time, all else remaining the same. However, one should not keep the same actuary for this reason only. The differences among models will not be so great as to justify sacrificing substantial costs savings or to justify retaining an actuary that does not work well with staff.

Several interviewees also recommended including a provision for alternative health benefit and/or alternative funding scenarios in the actuarial contract or request for a proposal so that these are included in the fees negotiated. It is likely that either senior management or the county’s elected officials will want to know how changing the benefit plan, such as moving from a defined benefit to a defined contribution health plan, will impact the ARC and AAL. Finance, HR, and elected officials may well want to be involved in developing these scenarios. After all, it is the government that best knows which health benefit changes are most possible and favorable. By including an option for calculating scenarios in the initial contract, the county can save money and time in contract amendments over the long run.

Some, but not all, the actuarial valuations segregated out the implicit-rate liabilities for the governments profiled. This information is important for counties that offer a blended premium rate (average insurance premium for active employees and retirees). One way to reduce the AAL and ARC is to eliminate this subsidy by adjusting premiums based on employments status and Medicare eligibility. However, a government cannot realistically consider this option unless it has the data. Thus the contract should include a provision asking specifically for both the implicit and explicit liabilities.

For governments who do not regularly contract out financial services, the Government Finance Officers Association (GFOA) has published a contract checklist. The checklist includes items like requested scope of services, information about the actuarial firm, the actuarial process, and costs. Because so many of the counties profiled here had begun their first valuations before the GFOA

checklist was published or were unaware of it, interviewees could not comment on its usefulness. However those counties that did see it, found it useful and one relied on it heavily to prepare its request for an actuarial proposal.

Finally, financial staff should remember that the actuarial valuation cannot simply be inserted wholly into the financial report. It will need to be taken apart before the information can be used for financial disclosure statements and footnotes.

CREATING AN IMPLEMENTATION PLAN

Implementation Philosophy and Plan

After receiving its actuarial valuation, a county can evaluate the possible impacts of the OPEB AAL and can plan for implementation. If a government shows a relatively small liability, approving significant policy changes to its benefit package or operating budget may be unnecessary, and the government can focus on the accounting mechanics of GASB 45. However, with a relatively significant OPEB liability, a government may need to look at alternative benefit scenarios and start to think about how the county will fund its ARC. Immediate questions include the following: Should the government fully fund the ARC in the first year of implementation, or should it “phase in” funding? Would advance funding of the UAAL be advantageous? Answers to these questions reflect the government’s implementation philosophy for GASB 45. Similarly, the government will need to consider the following: Does the county prefer to address the underlying components of the OPEB liability or to focus only on accounting implementation? The answers to these questions determine the level of collaboration with stakeholders, experts, and communication outlets, as well as the time needed for implementation.

To ensure that there is sufficient time for implementation, senior management should create an implementation plan with a timeline for important decisions. Senior management should also decide when to seek input from the county’s elected officials. Early in this process, the county needs to decide when it will communicate with retirees, union representatives, employees, and the general public 1) about proposed changes to OPEBs and 2) about significant fiscal decisions, like advance funding the AAL. Furthermore, senior management should determine which departments will be responsible for implementing what parts of the plan and which other organizations (e.g., unions) and outside expertise (e.g., financial advisor) will need to be involved. Appropriate levels and sufficient time for collaboration, communication, and evaluation are all critical to implementing the plan smoothly and timely.

Collaborating

Nearly all the counties profiled collaborated on GASB 45 implementation and all the counties that did so found those efforts very productive. Inter-departmental collaboration was particularly important for counties where the human resources (HR) department managed health insurance benefits because the finance office needed to work with HR to understand benefits and HR needed to understand the fiscal impact of health benefit amendments. Moreover, understanding the costs of retiree health care was very important in labor negotiations, which were typically managed by HR departments. Because GASB 45 is an on-going requirement, HR must continue to work with finance and budgeting offices on OPEB valuation and implementation. Similarly, finance staff need to improve their understanding of the health benefit packages to budget appropriately for the OPEB ARC. Counties with more specialized financial services (e.g., separate budgeting, accounting, and investment offices) may need higher levels of collaboration as well. Furthermore, when amending retiree health changes or creating an irrevocable trust, profiled counties often included their county attorneys. Because of the necessity for collaboration in nearly all cases, governments in the early stages of GASB 45 implementation may want to consider establishing a working group to foster communication and relationships among key departments.

Counties also found collaboration with external parties extremely helpful. In addition to working with their actuary on financial matters, some counties sought advice from their external auditor for specific accounting actions or advice on which actuarial assumptions to use for their valuations. Other counties looked toward their health benefit consultant for advice on amending OPEBs. Outside legal counsel were also hired to write trust agreements and/or bond covenants. These examples illustrate the multifaceted nature of GASB 45. They also make it clear that increasing the complexity of implementation (i.e., changing benefits, creating a trust, issuing debt) results in greater points of interaction amid additional stakeholders. While the interviewees found these interactions positive and helpful, they pointed out that these interactions also require time and need to be accounted for in the implementation plan.

RETIREE HEALTH BENEFITS AND CONTROLLING LIABILITIES

For many governments, the actuarial valuation will be both surprising and a “wake up call” that it cannot afford to maintain the status quo for OPEBs over the long term. As stated previously, GASB 45 did not create the financial liabilities faced by governments. It merely requires governments to recognize them in their accounting statements. The health care policies approved by elected officials, in some instances decades ago, created the county’s liabilities and

it will ultimately be the commissioners as the policy-making body that will have to approve any OPEB changes. Because the commissioners are so integrally involved with the solution to OPEB financial sustainability, they might also want to be engaged in developing the policy as well as in approving it. Although elected officials may be concerned about the political ramifications of amending OPEBs, they may be reassured to know that the commissioners interviewed found that the public appreciated their efforts to preserve money dedicated to programs and to save taxpayers' money. As one interviewee said, "Nobody likes making tough decisions (i.e., controlling liabilities), but it's the right thing to do."

Elected officials and staff stressed the importance of becoming educated about GASB 45 and the county's OPEBs. In order to make informed policy decisions, everyone involved should understand the liabilities and the political and legal constraints associated with different types of benefits. Interviewees recommended that counties carefully consider all options in order to avoid costly mistakes. Having actuarial information on different options is very helpful in this regard. More specifically, accrual accounting, the method used here, has helped governments realize the power of incremental change in either increasing or decreasing liabilities. Valuations calculating a change across an employee's lifetime (or until Medicare eligible), may show that a small cost under PAYGO can be quite large 15 or 30 years later.

A county needs to consider or develop a philosophy about OPEBs and that county's relationship with current and future retirees. Does the commission believe it is important to maintain the status quo for current retirees? Is the government willing to make changes for new retirees? How important are OPEBs relative to sustaining program levels for services or finding new revenues (i.e., tax increases)? Most counties already have an OPEB philosophy or set of values, but may have never fully or publicly articulated them. Many governments have never had to consider the trade-offs between OPEBs and public programs or tax increases because the PAYGO method continued to be affordable. Whether or not they create a formal document, elected officials may benefit from the process of articulating an OPEB philosophy. This, in turn, will serve as a guide for staff as they develop health care alternatives. These important policy decisions require input from the commission and should reflect the culture of the government and the community.

An OPEB philosophy can be integrated into an overall strategic plan for health benefits. Fairfax County created a strategic plan for employee- and retiree- health care several years ago, and the Human Resources (HR) Department uses it as a guidepost for administering health benefits, for making such decisions as how to reduce spending and where to redirect cost savings. A plan can

include goals, such as increasing program efficiency or improving employee health, as well as specific objectives such as reducing administrative costs by a particular percentage or developing a wellness program. It can serve as an information tool for unions, employees, retirees, and the public about what the government hopes to achieve and what actions for health care it will take in the future. Furthermore, elected officials can use the plan to evaluate requests for benefit increases. Through the plan, governments can evaluate data and discover potential problems or "red flags" as well. Finally, the plan can provide an important source of accountability in that the public can see the government's commitment to controlling this costly government benefit.

There are a myriad of external and internal factors involved in managing OPEBs, and there is no "one best way" to addressing liabilities.¹¹ These factors serve as constraints as well as point governments toward particular OPEB policies; they can be legal, economic, or political/cultural. External factors exist beyond the governmental organization. For example, several states mandate the ways in which counties manage OPEBs, such as requiring that counties contribute to a state-managed retiree health fund (e.g., New Mexico, Florida) or that they offer retirees access to the county health plans at the same premium as active employees (e.g., Nevada). In order to recruit and maintain a qualified workforce, the county must consider how its benefits compare to those of neighboring governments as well as those of private-sector employers. Historically, governments have offered richer benefit packages in exchange for lower salaries. If a government reduces benefits, will employees expect higher salaries in return? Finally, communities have distinct cultures and political attitudes. To the extent that a government not only serves, but also represents the values of the broader community, one should expect employment/retiree policies to reflect the public's values. It is the public that pays for those policies through taxes. Therefore, the commission will rightly approve only those policies that do not differ significantly from the county's political culture, whether that results in conservative or generous OPEB packages.

There are several internal factors to consider when amending OPEBs. These include labor-management relations, employee culture and policies, employee and retiree demographics, and the government's fiscal condition. The first includes any current labor contracts. A government may need to delay implementing health plan changes until a contract comes up for renegotiation. Governments have their own internal culture, which serves as a standard for what is considered appropriate or not in employee relations.

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11 Public Financial Management, Inc. Presentation for Florida Government Finance Officers Association. November 13, 2006. www.fgfoa.org/files/OPEB_Presentation_111306_JimLink.ppt

For those governments that negotiate labor contracts with unions, the government's culture will usually be reflected the contract negotiation process and in the contracts themselves. When evaluating changes to OPEBs, particularly health benefits, employee and retiree demographics will become particularly important. Is the workforce growing? What is the retirement trend over the next 5 and 10 years? What is the average age of retirees? This information will be important in deciding what benefit scenarios work best within the context of all these factors. Finally, the government's fiscal condition and expenditure demands are obviously critically important when evaluating benefit adjustments. If a county simply cannot afford the long-term costs associated with its retiree health plan, then it may need to consider more dramatic changes than a government with more budgetary flexibility.

OPEB Liability Management

Amending OPEBs, particularly for health care, requires a substantial level of research, evaluation, and therefore time. A county is likely to require input from multiple stakeholders such as the Human Resources (HR) and Finance departments, the actuary, a health care consultant, and, where relevant, union representatives. Due to the complexity of any benefit change, the following OPEB liability management topics are meant to serve as points of discussion and to introduce persons unfamiliar with the universe of health-care benefits to some of the options that are available. Every county profiled for this report has at least one of the options discussed below, but no options were applied universally, demonstrating the opportunities governments have to create OPEB plans that best suit their situations.

One of the first actions finance staff should undertake when beginning any evaluation of OPEBs is to talk with the HR department or the office responsible for supplying benefit information to employees and retirees. If it has not already done so, the government should clarify its legal right to make changes to OPEBs. Most important, the government's attorney should review any union agreements (current and historical) to ensure no written promises have been made to union members about supplying retiree health benefits. Staff should also add a legal disclaimer to all benefit information given to employees and retirees, stating the government's authority to unilaterally change OPEBs. As part of this effort, staff should clarify any definitions of health care plans for retirees early in the process so that the retirees understand what they will receive from the county and what is expected of them. Finally, HR staff

should be very careful about not accidentally making verbal promises about OPEBs to current or prospective employees.

Smaller counties whose staff do not have a high degree of expertise in health benefits or sufficient time to comprehensively research options, may profit from hiring a health-benefit consultant to help with an OPEB assessment. As a person who specializes in this area, a health care consultant can suggest a variety of benefit options, explain the status of the industry, and analyze the government's health-benefit expenditure data. This unbiased advice can be shared with the actuary to develop cost estimates for various benefit scenarios as well.

Grandfathering benefits

With any proposed benefit change, the county must decide whether it will grandfather, (i.e., leave unaffected), retirees and/or current employees. One strong argument against grandfathering is cost-savings. With grandfathering, it can take several years before

a government experiences significant savings from a benefit adjustment. Obviously, it will take longer to see savings if current employees are grandfathered than if only retirees are grandfathered. For example, Oakland County closed access to its defined-benefit health program to new employees in 2006, but existing employees and retirees will continue to receive this benefit.¹² The County estimates it will take approximately 11 years before the number of

defined plan participants leaving the plan is sufficient for the county to show significant cost savings in its actuarial valuation.

However, Oakland County, like any county that decides to grandfather beneficiaries, did so for some very compelling reasons. The first was retiree and employee acceptance. With grandfathering, these groups are not affected and hence have little reason to be concerned with the change. Incoming employees accept the new OPEB with the position. Grandfathering also eliminates any legal concerns about having promised a benefit to employees. If undertaking a dramatic benefit change such as creating health savings accounts and not grandfathering employees or retirees, governments might want to consider the financial impact on these groups. Obviously, retirees and employees nearing retirement would not have the opportunity to earn credit for a health savings account so a county would need to offer a "transition benefit" that would be



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12 New employees to Oakland County will receive a health savings account. For more information about this OPEB, please read the Oakland County profile.

roughly equivalent to the dollar value of the old benefit. Depending on the number of employees near retirement, this transition benefit could entail a significant expenditure. Finally, the political culture of a government may make it difficult not to grandfather these groups, particularly retirees. As individuals on fixed incomes, retirees can often share a compelling story about why their benefit should not be reduced.

Benefit Eligibility Requirements

To encourage longevity with the county and also reduce OPEB expenditures, many counties require that a retiree begin receiving a pension from the county in order to start receiving OPEBs. This policy also eliminates the county's responsibility for paying OPEBs to an employee who may work 10 years for a county, but then leave and work elsewhere. However, for some counties that do not have age limits on retirement, this policy may encourage employees to "double dip" their health benefit if working a second career. The most common example would be a public safety officer who retires from a county at the age of fifty with 25 years experience. Not being ready to fully retire, this individual works an additional 10 years at another occupation; however, in order to avoid losing the county's OPEBs, he or she accepts the county's health benefits, even though health benefits are available at the new place of employment. In essence, this retiree has used the county's pre-Medicare OPEBs for 15 years rather than 5.

There are several alternatives available for addressing the example just given without creating a window for former employees who have served the county only a few years to receive OPEBs. To encourage the above discussed public safety officer to use the second employer's health benefits and save the county 10 years of OPEB expenditures, the county could amend its policy so that the retiree can reinstate county OPEBs with proof that he or she maintained health insurance coverage during the interim. Many counties are also extending the required years of service to qualify for OPEBs. Even if a county's pension mandates only 5 or 10 years of service to vest, OPEBs can require 15 or 20 years of service. A government can also include a minimum age requirement for receiving OPEBs (e.g., 60 years old), thus excluding the 50-year-old public safety officer. A few of the counties profiled have recently extended either the years of service or the minimum age requirements (or both) for receiving OPEBs. An additional argument for increasing the required years of service or extending the retirement age is that this change rewards long-serving employees. If a county institutes such a change in policy, some transition or grandfathering accommodation is likely to be necessary for employees planning on retiring in the very near future; normally, current retirees would, of course, be unaffected. Though not dramatic changes, these two alternatives can save governments significant dollars in their AALs. For an example, read the Harris County profile.

Changes in Premiums Contributions

If wanting to maintain the OPEB structure yet reduce OPEB liabilities, a government can lower the percent of the premium its pays for health insurance to retirees and/or current employees. When the change is extended to current employees, savings can be significantly greater. If a county offers multiple plan options, a government can pay a percent of the least expensive premium (e.g., Sonoma County). However, by continuing to pay a percent of a defined contribution insurance plan, the government continues to bear the risk (cost) of higher medical costs in the future, and therefore liability reductions are less than those resulting from moving to a defined dollar contribution or health savings account benefit, discussed below.

Changing premium rates among participant groups can eliminate or drastically reduce a government's implicit-rate subsidy as well. Governments that only offer health plan access to retirees (retirees pay 100% of premium) will still incur an implicit rate liability if the premium is a blended rate. To eliminate this liability, governments can tier premiums between active employees and retirees or pre-Medicare retirees and Medicare-eligible retirees. The most expensive rate would be for the pre-Medicare retirees; however, this group usually has more financial resources than older retirees. Tiered premiums encourage employees to work longer as well. Read Shelby County's profile for an example of this policy.

Interviewees offered two other suggestions about changing premiums:

- 1) If keeping the blended rate, self-insured counties (health care) should set the premium to fully fund the health system's costs, including the implicit-rate subsidy. All groups pay a higher premium, and the excess would go toward funding the ARC.
- 2) By making a decision early, a county can incrementally raise the premium over time, reducing "sticker shock." One negative with this process is the impact on retirees and/or current employees paying increases over multiple years.

Defined Dollar Contributions

Under a defined dollar contribution plan, a county gives eligible retirees a specific amount of money, typically on a monthly basis, for medical premiums. Under this option, the risk of medical cost increases resides with the retiree, and therefore results in lower OPEB liabilities for the county. This contribution method allows the county substantial flexibility. The amount offered might or might not be contingent on including spouses/dependents, might or might not be restricted to paying premiums for the county's health plans, and might or might not differ based on Medicare eligibility. (A differential for Medicare-eligibility is typical of the counties in this study.) Counties can also set the amount of the contribution based on years of service. To control costs, coun-

ties reserve the right to control if or when to increase the subsidy. When moving from a defined percentage contribution to a defined dollar contribution, counties should consider establishing a dollar amount that is based on the monetary value currently given to retirees. For example, if the least expensive plan premium has a dollar value of \$250 per month, the county may want to offer that level of benefit. By making the defined dollar contribution comparable to the current benefit, counties can more easily “transition” retirees and current employees to the new plan. To learn more about a government that has recently moved to this type of subsidy, read the Gwinnett County profile.

Health Savings Accounts

Health savings accounts work as true defined-compensation plans. During an employee’s career, the government contributes money, typically each pay period, to this person’s individual health savings account, much like a 401K retirement plan. When the employee retires, the county ceases to have any financial liability to the employee. The retiree can use the assets from the account to pay medical expenses, such as insurance premiums and co-pays. County contributions are invested in mutual funds, and the employee has some control over directing his or her money.

A county has a high degree of flexibility in establishing these accounts as well. The county can decide to give a universal contribution per pay period or adjust it for spouses, years of service, etc. The government can also include vesting requirements to encourage employee longevity. If moving to this method of contribution, the government will either need to create a transition benefit or grandfather existing employees. The transition benefit should be based on years of service times a dollar contribution with an amount that includes assumed interest earnings. However, moving existing retirees to this system is likely to be very difficult due to economic and political or social concerns.

Because the government pays all its liabilities to employees each year and that liability ends upon the employee’s retirement, there are not accrued long-term liabilities with this type of benefit. However, if the government allows retirees access to the health plan and the premium rate is blended, there will continue to be an implicit-rate liability. The one perceived negative of this benefit is the requirement to fund OPEBs annually. The county cannot delay funding the liability (i.e., ARC) during times of fiscal stress, as can be done with defined-contribution plans. See Marathon County to learn more about health savings accounts.

Plan Access

Simply offering retirees access to the county health plan can be considered a benefit. Many retirees younger than age 65 have difficulty finding high quality health insurance at a reasonable rate.

For counties that offer a blended rate, the implicit-rate subsidy is equivalent to several hundred, if not thousands, of dollars worth of benefits to a retiree annually. Individual rate premiums are often 40%-60% higher than group insurance premiums. Because retirees may think they are truly paying 100% of the premium, the benefit of this saving should be advertised to employees and retirees.

Other Recommendations for Managing Health Care Liabilities

Human Resource Directors were asked for recommendations for lowering health care costs, and they provided several additional recommendations that can be integrated into the overall management of an HR department. Many governments already incorporate some of these recommended actions but, for those that do not, they may be worth deliberation.

When thinking about OPEBs and benefit packages generally, a government should not assume it knows its employees’ priorities. It is worth asking employees how important retiree benefits are, particularly compared to salary increases. For example, how important are dental and vision benefits? Often younger employees are less concerned about retirement and more concerned with current benefit and salary levels. If employees are not very interested in receiving OPEBs, governments may want to consider amending these so as to protect benefits for active employees.

Knowing employee wants is directly linked to regularly reviewing and updating benefit offerings. Benefits assessment should not be a once-a-decade endeavor. The HR director should spend time staying abreast of industry changes in order to look for administrative and service delivery savings. As one interviewee stated, “Adjusting health plans should not be done solely for GASB 45, but it should be expected as part of an ongoing effort to manage health care costs.” Furthermore, by regularly examining and adjusting benefits, a government may face less resistance to more significant policy changes in the future. Some interviewees recommended that counties undertake actuarial assessments for all proposed benefit changes in order to let commissioners, employees, and union representatives see the full cost of the proposed amendments.

Beyond the needs of GASB 45, several counties regularly hire health care consultants because they value the expertise and independent voice the consultants offer. These persons collect and analyze trend data on program members, claims, and expenditures, and they research benefit options for cost savings.

Counties across the country, including those profiled here, are instituting wellness programs as a means of controlling health care costs. These programs are generally limited to active employees, though some counties are considering offering these services to retirees as well. Access to health fairs, classes in healthy eating,

chronic disease management, and even access to exercise facilities (e.g., on site gyms or discounts for gym memberships) are becoming common. Since pre-Medicare retirees are the most expensive group to insure, encouraging healthy lifestyles for this group could be beneficial to a county.

There tend to be two major difficulties in including retirees in wellness programs. One involves simply reaching them, since some may have moved out of the area or simply have not stayed abreast of county activities. Another is that this group may be more “set in their ways” and not as open to changing their habits, healthy or otherwise. Retirees interested in good health probably already perform the necessary activities for managing chronic diseases and those that do not might not be interested. To address the first problem, the county could partner with its retiree association, providing information in newsletters. The second issue would be much more difficult to tackle. However, research on geriatrics is finding that baby boomers have substantially different attitudes toward aging than their predecessors, particularly when it comes to being active. As this employee population retires, counties may be more successful in reaching this group and offering educational (classes on healthy cooking and disease management) and recreational (walking groups) activities that would be attractive to their former employees.

GASB 45 Advice for Human Resource Professionals

Finally, the HR Directors offered advice on GASB 45 for their colleagues:

1. Become educated about GASB 45 liabilities and realize that it is not merely an accounting exercise. Share your expertise about health insurance with others working on the accounting statement in order to be part of the GASB 45 solution.
2. Understand the actuarial valuation, including the assumptions, AAL, and ARC. As a warning, the OPEB valuation is more complicated than a pension valuation and will probably require more time to learn and digest. If necessary, find outside help in understanding the report.
3. Realize you may not be able to “fix” health benefits and control costs all at once. Reaching significant changes to health benefits may require several adjustments over a period of time. Think about the palatability of a benefit change from both the government’s and the employees’ (union) perspectives. Remember that the government still needs to recruit and retain qualified employees, and retirement benefits are a recruiting tool. The ultimate goal is to find a happy medium by compensating employees and minimizing costs for taxpayers.
4. Effectively communicate the message about the long-term consequences of uncontrolled health costs to unions and employees. Make the costs real, particularly with regard to future costs (ARCs) if plans are not sustainable.

In closing, seeing the actuarial reports and learning about OPEBs helped many of the interviewees to think more realistically about their county’s health plan. Now senior staff and elected officials have to consider not only what the county can afford today, but also what it can afford twenty years into the future. By preparing for future fiscal demands, the county has also increased the likelihood that it will have sufficient resources to offer future retirees retiree health benefits.

FUNDING OPEB LIABILITIES

Funding the ARC (Annually Required Contribution)

Just about every county that offers OPEBs, and in particular retiree health care, will have some ARC to pay under GASB 45. For many, the ARC will far exceed current PAYGO amounts, creating real budgeting challenges. Funding decisions for the ARC are essentially the same as other budgeting and finance decisions in that they are political and involve tradeoffs. However, these decisions can be more difficult in that the county cannot point to a particular program to show where the increased public revenue has been spent. How (or whether) a government chooses to fund its ARC will be a reflection of its political culture and financial resources.

Most county officials have become experts in finding creative ways to fund obligations, and implementing GASB 45 will be no exception. For the first year of implementation, several of the counties profiled are using a mix of one-time and operating revenues to fund their ARC. Others are phasing in full funding over a number of years (e.g., 3 or 5); however, with this option the government should be prepared for lost interest earnings and unfunded accrued liabilities. Some counties are using one-time revenues, like their excess general fund balance, to “jump start” their OPEB trust funds and begin collecting earnings from trust fund investments.

One option for funding OPEBs with current revenues is to cost-allocate the ARC across all funds. Through cost allocation, all revenue sources pay a share of the OPEBs, reducing the burden on the general fund. Cost sharing increases interfund equity, particularly with funds that have personnel funded from them, like enterprise funds for utilities. Furthermore, similar to allocating countywide administrative costs (commission, county manager, HR, budgeting, information technology), all funds benefit from the services of administrative employees, and hence should pay a proportionate share of their OPEBs. If a government has not established a cost-allocation formula for support services, establishing one for OPEBs will take some time and effort. However, two counties profiled (Hillsborough and Shelby) took a straightforward approach to allocating their ARCs, basing the allocation on positions/salaries located in each fund/department. If a fund did not pay for any

positions, it did not have an ARC allocation. Because the salaries and positions were well known, calculating the liability for each fund or department was rather straightforward. See these counties' profiles for more details.

To formalize their commitment, some counties are approving ARC funding policies. These can take the form of specifying the number of years the county will take to phase in full funding of the ARC (e.g., Montgomery) or of making a commitment to fully fund the ARC each year (e.g., Gwinnett). Establishing a formal policy shows financiers of government, credit-rating companies, employees, and the public the county's commitment to meeting its OPEB liabilities. This formal commitment may have more power for counties that are phasing in funding over a few years. The formal policy tells credit-rating companies that the county is committed to fully funding the ARC even though only a portion will be funded during the first few years of GASB 45 implementation. Some staff interviewed were hesitant to have their counties establish ARC funding policies in order to retain budgetary flexibility, particularly during times of fiscal stress. Key decision criteria for approving an ARC funding policy then are first, whether the county will be phasing in full funding and second, the fiscal condition and resources of the county. For example, a county that has limited its ARC, has a healthy fund balance, and is growing economically would be in better shape to approve an ARC funding policy than one that is under fiscal stress. A county can add flexibility into the fiscal policy by stating it as a goal rather than as a steadfast commitment to fully fund the ARC annually. The government can also require that a minimum percentage of the ARC be funded each year, but not necessarily 100%.

Advance Funding: Bonds / COPs

Though GASB 45 does not require employers to advance-fund their OPEB obligations, some governments have or are considering advance funding their AAL by issuing long-term debt. There are many benefits as well as risks and considerations that go into such a significant action. This section will briefly highlight these issues, but the decision to advance OPEB obligations should reflect a county's thorough analysis and unique financial situation.

OPEB bonds are similar in concept to pension obligation bonds in that the government substitutes one form of liability for another. In other words, by issuing debt at the full value of the UAAL, a government eliminates its OPEB liability, but accepts principle and interest payments for long-term debt. Depending upon state authorization, governments can issue either general obligation bonds and/or certificates of participation (COPs). General obligation debt is backed by the full faith and credit of the issuer, will be included the government's permissible debt limit, and requires a referendum. COPs are trust agreements in that the government does

not promise to tax itself in order to repay the debt and payments are subject to annual appropriation. However, the government will have to offer an asset such as a building as collateral. Though the debt instruments are structured somewhat differently and the risk differs for the bond buyer, the considerations for issuing either a general obligation bond or a COP remain very similar.

OPEB bonds constitute "risk-bearing arbitrage" in that the government's goal is to invest bond proceeds and earn investment returns that are substantially higher than the interest paid on the debt. These additional earnings can then be used to fund the ARC in lieu drawing from other operating revenue. Because of federal prohibitions on using tax-free debt for this purpose, governments must issue taxable debt, which increases the interest rates governments must pay in order to attract investors and thereby lessens the differences between potential interest earnings on proceeds and the cost of debt repayment. To achieve investment earnings at rates that are higher than the bond interest, the government will need to take on some degree of investor risk, typically by investing in market securities and bonds. Of course, investment management is undertaken by professional money managers with oversight by a public body.

If considering advance funding for OPEB liabilities, there are several important issues a government will need to consider and address. First are legal considerations. The jurisdiction must research what authority it has in issuing debt. Several states do not allow local governments to issue OPEB G.O. bonds. In these instances, the government might want to evaluate the benefits and limitations of issuing a COP instead. Second, governments retain the right to amend or eliminate OPEBs, and the government should evaluate whether either might occur. Finally, governments should clearly state in their bond covenants that issuing bonds does not create a promise or contract with employees and retirees to offer OPEBs in the future.

Additional concerns exist about the uncertainty of actuarial valuations of OPEBs. As stated earlier, predicting the future cost of health care can be difficult due to variances in utilization by retirees and employees, advances in medical technology, and community expectations about the quality and availability of services. These factors raise uncertainty for debt issues. In contrast, key assumptions for pensions, like the amount of benefit received and life expectancy, are more predictable. However, a government that underestimates its AAL and has debt proceeds that are less than its AAL will not necessarily be harmed. Instead, the government will have both debt payments and an additional ARC to fund. If the government had not issued the debt, the full ARC and AAL would still be liabilities for the government. A more significant problem comes from issuing too much debt and being unable to refund it.

Proponents of OPEB bonds appreciate that advance funding may not be appropriate for all counties. Laurie Van Pelt, Director for Oakland County's Department of Management and Budget offered several conditions that should exist before a government issues OPEB bonds¹³ including:

- OPEB estimated liability has been determined by a professional actuary;
- Action has been taken to limit future growth of the obligation;
- The county has a favorable bond rating;
- There exists a reasonable expectation that proceeds from the retirement health care trust investments will significantly exceed the estimated total debt interest expense as substantiated by a history of retirement investment earning performance that demonstrates sufficient anticipated earnings;
- There exists a clearly identified source of funds to pay the annual debt service.

How the debt issue is structured can help in alleviating some but not all of the above concerns. The debt can include a call provision to address circumstances when the government no longer needs the OPEB revenue; however, if future interests are lower than those on the debt, the government will lose income for early repayment. Serial bonds can also help to stabilize debt repayment. Again, this option is not always preferred by bond dealers, and so a government may pay a higher interest cost as a result. The government can offer fixed or variable rate obligations, but each has different levels of risk and costs attached. Because OPEB bonds/COPs are fairly new investment instruments, bond buyers may need to be educated about OPEB long-term debt in order to feel confident about the security of the issue. Some experts recommend using a negotiated sale with an underwriter, while others believe that having a strong credit rating and competitive sale is a better way to go.

Their complexity demonstrates the importance of sound data and careful deliberation before issuing OPEB bonds. Again, a good actuarial valuation to know how much OPEB liability exists is very important. The county should seek expert advice from a financial advisor, particularly one who would not participate in the bond sale and hence would neither gain nor lose from a debt issue. Elected officials should have an open dialogue about the bond with all stakeholders, including employees, retirees, and the public. This last group will ultimately be responsible for debt repayment and should be informed about the debt prior to issuance. Finally, the government should have its "ducks in a row" before issuing the debt, making provisions ahead of time for asset management such

as establishing an oversight board, financial accounts, investment policies, and a trust fund.

Even with these considerations, some governments are issuing long-term OPEB debt because they expect to save them millions of dollars in OPEB liability over the life of the issue. Properly planned, advance funding can be a successful option for some governments to fund an OPEB AAL.

To learn more about OPEB COPs, read the Oakland County and Sonoma County profiles. Oakland recently issued an OPEB COP, and Sonoma County is considering issuing a COP as well.

MANAGING OPEB ASSETS

Financial officers will develop the financial management "nuts and bolts" for OPEB assets, such as creating budget accounts and developing GASB 45 footnotes for the annual financial statements. However, there are two areas for policy deliberation: creating trusts and developing investment policies.

Trusts

OPEB trusts are fiduciary funds, meaning that the assets are being held by the government on behalf of some other group, in this case retirees. Because they are irrevocable, the government cannot unilaterally take money from the fund and spend it for some other purpose. There have been occasions when governments have borrowed money from a pension trust fund and spent that money on operating expenditures. However, this is a loan, and the government must repay the pension trust. This action is not considered best practice in public financial management.

There are some compelling reasons for creating an irrevocable trust, but these are dependent on having assets to put in it. The benefits of fully funding the ARC are integrated with those of creating a trust. In essence, the money a government sets aside for a trust (above the PAYGO amount) can earn investment income and be used to offset future liabilities. Since trust management takes a long-term perspective, the government can expand its investment options to include relatively risky investments, such as market securities and bonds, which can translate to higher earnings. Similarly, governments benefit from applying a higher discount rate to their actuarial valuation when utilizing a trust which lowers the AAL (actuarial accrued liability) and the ARC (annually required contribution). Nevertheless, governments should choose a conservative discount rate if creating a trust, particularly if the county does not have experience in trust management. While a high discount rate may lower a county's ARC and AAL initially, if investment earnings are not sufficiently high, the ARC and AAL will again go up at the

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13 Van Pelt, Laurie. Letter to Government Finance Officers Executive Board dated October 2, 2006.

next valuation. Finally, from an HR perspective, the trust provides greater security to employees because the government has set aside assets to fund future OPEBs.

The limitations of irrevocable trusts stem from their “inflexibility.” The inflexibility means that governments need to be concerned about 1) alternative health care scenarios and 2) alternative uses of and access to revenues in the OPEB trust, should it no longer be needed for its original purpose. The concerns are similar to those faced if advance funding the AAL. One scenario receiving significant attention is national health care. If the federal government creates a national health care plan which is paid by the federal government, local governments’ obligation for retiree health care may cease to exist, leaving governments with assets for expenditures that they no longer pay. Another less dramatic but similar situation would occur if a future commission decided to significantly reduce or eliminate retiree health care. To overcome this dilemma, some governments are including specific language in trust agreements that would allow the dissolution of the trust in the event federally-funded national health care becomes a reality. Counties will want to work with their legal and financial advisors when developing trust agreements to address these kinds of circumstances.

If a government has decided to establish an irrevocable OPEB trust, the county (usually, senior management with final approval from the elected body) will need to create a management plan, such as assigning a separate investment board or county official (e.g., county treasurer) with authority to hire investment managers and create investment policies. The county commission would need to approve any agreement that assigns authority for managing the trust to a separate oversight body, like a retirement board. In instances where the retirement board has a long, successful history, this would almost always be the best option for a local government. Gwinnett County recently created an OPEB trust and new board to oversee it. The OPEB trust and board are briefly described in the county’s profile.

Overseeing and managing trust funds requires substantial financial expertise, particularly in order to earn maximum returns on investments while also limiting the government’s risk. To ensure accountability, the county should separate trust oversight from money management so that the oversight body does not actually make investments but approves fund managers. In other words, the county should create a system of checks and balances in its financial management policies. Furthermore, as part of the trust management plan, the county needs to develop written guidelines for hiring fund managers. To review performance of these managers, the oversight board can utilize performance measurement techniques as well.

Some states are allowing counties to join state-managed pooled trusts, much like state retirement funds. For smaller counties that do not have the financial expertise to manage a trust or the resources to leverage a significant amount of money in order to maximize earnings, this option may be a very good idea. Some counties are independently creating pooled trusts to maximize investment earnings. Through a pooled trust, a county can reduce administrative costs, and yet still afford higher levels of expertise. However, financial officers should ask about the legal and accounting implications of sharing resources. The county needs to fully appreciate what it is committing to doing, including what the agent relationship will be with trust members, and how the risk will be shared.

Some governments are choosing not to utilize an irrevocable trust. They are willing to forego the higher discount rates associated with an irrevocable trust in lieu of maintaining access to the assets. These counties are depositing the revenues in special revenue or internal service funds. By depositing money in these types of funds, the governments are likely to face state restrictions about how the assets are invested. Typically, these restrictions attempt to limit the government’s exposure to market risk, permitting investments only in government bonds, insured certificates of deposit, etc. For examples of governments either choosing or considering this option, read the Hillsborough and Harris County profiles.

Investment Policies

Most governments have already established fiscal policies related to investing fund balances in short-term investments. However, irrevocable trusts will require a new set of investment policies in order to ensure the county balances investment risk, needed investment flexibility, and financial accountability. Financial staff, the county treasurer, auditor and/or other internal financial experts will usually take the lead in developing draft investment policies. However, the county commission may want input in creating investment policies for the OPEB trust, or it may choose to delegate that responsibility to the trust oversight body. If members of the organization do not have experience with investing trust assets, it may be useful to seek assistance from a financial advisor. Moreover, the county can look to other local governments in the state or the state government itself for ideas about effective policies.

Effective fiscal policies have several components. The content of the policies should address issues related to risk, liquidity, earnings, and portfolio diversity. The government may want to develop hiring policies and job descriptions for financial managers, to avoid concerns over favoritism or to prevent inappropriate levels of risk arising from allowing one financial manager substantial control over trust assets. For investing, the government will need formal policies that have been approved by the trust’s oversight body. Formal policies promote stability for the government, standardize op-

erations of the trust, and promote long-term thinking. However, policies need to be periodically reviewed to ensure their continued relevancy and conformity to best practices.

Fiscal policies can be classified as either actionable or philosophical. The former authorize financial managers to act based on the status of a performance indicator; the latter state general policy goals. An actionable policy would dictate that no more than a certain percentage of the assets will be invested in a single type of instrument, while philosophical goals might discuss the county's commitment to ethical investment choices. Actionable policies emphasize accountability, while the philosophical policies stress flexibility. The government's goal is to balance the two. In other words, the policies need to be flexible enough so that financial managers can reach earnings expectations, but do so without exposing the government to substantial risk. Ideally, fiscal policies should balance best practices, accountability, flexibility, and financial success in a way that reflects a government's political culture and values.

INTERNAL COMMUNICATIONS

Counties should not underestimate the importance of effective communication when implementing GASB 45. For those counties that are planning on significant changes to OPEBs or are considering a tax increase to fund the ARC, communication with elected officials, union representatives, employees, and retirees will be especially significant.

To help ensure that all stakeholders, including the public, understand what the government plans to undertake, the county should create a communication plan with timelines. When developing the plan, staff should think about what the various audiences would want to know and how to reach each group most effectively. For example, what do elected officials need to know about GASB 45? How can the county best reach retirees if changing their health benefits? The county might want to include its public information officer (PIO) when creating the communication plan, along with other key GASB 45 implementation staff, including the human resources and finance directors; involving all key implementation staff ensures that they are all relaying a correct and consistent message. Having the PIO officer involved can be very helpful if the county anticipates attention from the local media or from concerned local citizens.

Each of the profiles in this report discusses the extent to which counties have communicated GASB 45 to various stakeholders. For profiles where this topic is discussed in relatively more depth, read those for Shelby and Sonoma Counties.

County Commission and Senior Management

For most counties, either the Finance Director or Human Resources Director will take the lead in implementing GASB 45, and therefore be responsible for educating senior management (i.e., the county manager) and county commissioners about it. All the staff that had discussed the accounting statement with their elected board felt that the education process went successfully. Many followed comparable approaches to communicating about GASB 45 and the county's liabilities with their boards and offered similar advice for those staff who are beginning the process.

Several staff recommended talking with board members sooner rather than later. As one human resources director said, "It is better to say, 'In 3 years we need to do this or that,' and be prepared, than it is to say, 'This year we need to do this or that.'"

Generally, staff waited to speak with their county commissioners until after they had received the county's first actuarial valuation. The valuation provided context for GASB 45 and made the statement more real. In other words, staff could show through the county's own liabilities the differences between PAYGO and accrued liabilities. In preparing for those meetings, interviewees recommended that finance directors take time to fully learn the valuation and be prepared to explain it in multiple ways. Staff also incorporated a discussion of the county's current OPEBs and employee health care policies so commissioners could link drivers of the liabilities to the dollars in the valuation. Finally, many staff discussed how funding the ARC and GASB 45 related to the county's credit rating. This last point often made a significant impact on the commissioners in terms of why funding the ARC and controlling OPEB liabilities was important for the county.

For counties that do not manage their own pension fund or do not have a commission well versed in governmental accounting, effectively educating commissioners is particularly important. Most staff recommended simplifying the OPEB and actuarial information to make it understandable, focusing on the big issues rather than many details. A few staff focused on the ARC more so than the AAL as well because the former was more immediate and not so large, helping commissioners to fully appreciate the impact of accrual accounting on OPEB obligations. However, as stated earlier the finance director still needs to fully understand all aspects of the valuation in case asked about detail by the commissioners. Furthermore, staff should be prepared to discuss what GASB 45 will mean to the government and its retirees.

Staff should also be sensitive about the process by which they educate commissioners about GASB 45. They might want to consider having individual meetings with commissioners in order to explain GASB 45, OPEBs, and the valuation so that commissioners can

ask questions apart from public scrutiny and in a safe environment. The goal is for the commissioners to learn, and if they are unfamiliar with these complex governmental terms, they need to feel comfortable asking questions. In addition to these private meetings, public hearings were held to provide information to the public and to approve the policy changes and/or resolutions.

Finally, commissioners themselves have an obligation to learn the key GASB 45 issues for their county. As one commissioner interviewed stated, “Hunker down and learn the issues; don’t ignore GASB 45.” A few interviewees discussed the benefit of having a GASB 45 champion on their commission who took the time to educate fellow commissioners about the issues and took an active role in supporting necessary OPEB changes and/or ARC funding decisions. Furthermore, commissioners may need to explain at least the highlights of GASB 45 and OPEBs to constituents (e.g., retirees), if only to articulate key points. Of course, if a constituent asks about the finer details of the county OPEB valuation, the elected official may want to refer that person to staff.

Retirees, Unions, and Employees

Other than commissioners, the persons who will be most interested in GASB 45 will be retirees and employees. The staff should avoid surprising these groups by getting information about proposed OPEB changes to them early in the process. Extensive outreach can be difficult and time-consuming in the short term, but it is the best way to maintain the confidence of employees and the public. Interviewees offered several lessons learned, stemming from their own communication successes and challenges.

To avoid exposing the county to unnecessary risk, several interviewees recommended that public officials should be the first to communicate GASB 45-related policies, rather than relying on other parties like union representatives or retirement associations. County officials can appreciate that nobody likes to be the bearer of what might be perceived as “bad news.” Therefore, counties should not expect external organizations to quickly or happily discuss changes to OPEBs that result in their members paying higher health costs. Furthermore, other organizations might include their own “spin” when delivering the GASB 45 information the county gave them. Although being the initial and primary source of information requires additional time, counties benefit from controlling the message and can thereby prevent stakeholder misperceptions. For counties that are not implementing significant OPEB changes, creating partnerships with these associations may involve less risk and result in greater benefits when unions and retirees associations willingly and quickly reach their members about the government’s OPEB/GASB 45 decisions.

Though delivering the message to employees and retirees directly, counties should always keep union representatives updated on county actions to foster open communication and trust throughout the process. If a county is considering significant health benefit changes and its organizational culture includes strong union representation or employee political empowerment, the commission may want to involve stakeholders at the beginning of the process. Counties could engage stakeholders in finding an affordable retiree health care package, and through the engagement, achieve a concomitant acceptance of the changes. However, counties should not let stakeholders abuse this access by slowing down the process of adjusting benefits. Commissions need clearly to state their authority to change OPEBs to union representatives, retirees, and the public so that everyone understands that stonewalling is not an effective negotiation tactic.

Interviewees offered several excellent techniques for reaching employees and retirees. As long as the information conveyed is factual rather than opinion, unionized counties should be able to utilize these techniques without violating labor agreements.

- Have a trusted spokesperson, such as a local mayor, share the county’s GASB 45 message with retirees and employees. This person’s word will have more weight than an unknown staff member.
- Write letters and send them directly to retirees.
- Use bulletins and newsletters sent to employees and retirees.
- Organize departmental meetings where senior staff discuss possible OPEB and employee health care adjustments.
- Include GASB 45 information on the county’s website and make it easily found.
- Attach notices to pay stubs for active employees.
- Hold public workshops and hearings that discuss OPEB alternatives and their impacts.

GENERAL PUBLIC

For many of the counties profiled, neither the press nor the public were particularly interested in GASB 45. However, public interest will vary by community. If a government is considering raising taxes either to advance-fund its AAL or to pay the ARC, staff should not assume the public will be unconcerned about the government’s OPEB liabilities and actions. Even if the broader community will not be directly impacted by OPEB changes, some interviewees advocate reaching out to all residents, not the employees or union representatives only.

Many of the ideas for communicating with employees and retirees apply to the general public as well, such as adding GASB 45 information to the county webpage. In addition, some interviewees

supported using town hall meetings so that everyone hears the same message directly from the county and not via hearsay. Some interviewees also wrote Op-Ed pieces for their local news paper in order to explain the county's position on GASB 45 and OPEBs. The key idea is for the county to take the initiative and deliver the message itself rather than relying on third parties who may not fully or accurately explain the county's position.

As all those involved in government know, the best laid plans can easily break down due to lack of effective communication. Confusion and misinformation can be prevented through proper outreach, particularly with key stakeholders. For counties that are planning on significantly amending OPEBs or their funding mechanisms, advance funding the UAAL, or raising taxes, the lessons learned from other counties become particularly relevant and should be taken into consideration. Counties should consider what can be gained through openness and communication versus what can be lost if the community or valued segments of it, such as union members and retirees, feel threatened or scared of the future. As one interviewee said, "No one likes surprises."

EXTERNAL COMMUNICATIONS

Organizations outside the government are playing critical roles in GASB 45 implementation. Credit-rating companies are one of the major forces behind the choices governments are making as they address their health care obligations and consider ways of funding their ARCs. Other important players or potentially important partners are state governments and statewide county associations. These organizations have an opportunity to assist counties with GASB 45 and OPEBs now and into the future.

Credit-rating companies

Though credit-rating agencies have no authority or direct role in GASB 45 implementation, these organizations are critically important stakeholders for governments across the country. These companies provide opinions on the credit worthiness of state and local governments to lenders who use this information to determine whether and at what interest rate they will loan money (e.g., buy bonds, COPs) to governments. Furthermore, for many governments, a high credit rating is source of pride because it reflects the fiscal health and management practices of the organization.

For governments that are not rated either because they are small or because they do not issue long-term debt, the perspectives credit-rating companies might not hold much interest. However, since these ratings are an indication of "best practice" for financial management, these counties could still benefit from learning the ex-

pectations of these companies in order to ensure that they too are performing at a superior level.

Why do credit-rating companies care about OPEBs? Because of GASB 45, these companies now have a more complete picture of a government's total long-term obligations and can therefore better assess a government's fiscal health and ability to repay debt. Reasonably, many governments are concerned that their OPEB liabilities could negatively affect their credit rating, making borrowing more expensive. Thus these governments want to know the expectations of the credit-rating companies in regard to managing these obligations.

Based on interviewees' comments on their discussions with credit-rating companies as well as published articles, "liability management" appears to be a key phrase when thinking about the perspectives of the credit-rating companies. Moody's and Standard and Poor's are not expecting governments to eliminate OPEB obligations immediately. Instead, they expect governments to have a plan for keeping OPEB expenditures in line with revenues, and they want to know how governments will pay for the benefits offered over the long term. Again, controlling liabilities is likely to be a component in determining credit worthiness. Governments that have already addressed this issue, e.g., by implementing a defined dollar contribution for health care premiums or utilizing health savings accounts, might not require any further changes to their OPEB policies. Furthermore, most governments will not have to find a complete and final solution overnight. The rating companies want to see steady and thoughtful progress in this area. However, governments should not interpret this to mean they can delay making changes for a few years; delay is not the equivalent of progress.

Experts in the public finance field are also discussing what credit-rating companies' expectations will be for governments implementing GASB 45.¹⁴ One presentation from Public Financial Management, Inc., for the Florida Government Finance Officers Association offered this information about OPEB Rating Factors from Standard and Poor's:

- Are the consequences of OPEB obligations fully understood?
- Where does OPEB rank in relation to other planning priorities?
- How conservative or aggressive are planning assumptions?
- Is the budget able to afford the OPEB ARC?
- What are the legal obligations of the employer to meet retiree health care obligations?

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14 Public Financial Management, Inc. Presentation for Florida Government Finance Officers Association, November 13, 2006. www.fgfoa.org/files/OPEB_Presentation_111306_JimLink.ppt

- How does the OPEB alter the competitive landscape regarding long-term liabilities?

Because long-term OPEB liability information is so recent, the perspectives and decisions of the credit-rating companies are likely to evolve over time. Governments that have yet to implement GASB 45 have the benefit of learning from first-phase implementation counties and can see how their liabilities and implementation “stories” have affected their credit ratings.

States Governments and State County Associations

Some state governments (e.g., Nevada) are offering their local governments the option of joining statewide OPEB trusts, much like governments participating in a state’s retirement fund. Local governments retain the responsibility for complying with GASB 45 and can typically decide how much of their ARCs they will contribute each year to the state trust. Similar to pooled pension trusts, the governments receive earnings in proportion to those deposits. The trust administrator might subtract from the earnings for administrative costs as well. As discussed in the Trust Section earlier, the benefits of this option may be particularly appealing to smaller governments for four primary reasons:

An ability to achieve economies of scale in investing by adding the government’s assets to those of other organizations and in turn to have access to more investment instruments with higher rates of return.

- 1 The ability to share administrative accounting expenditures.
- 2 Access to a high level of trust fund management expertise, particularly in regard to investing.
- 3 Access to a higher discount rate, which lowers the ARC and UAAL.

The primary negative with a pooled trust is the lack of control a member government has over the daily management of the trust and its investments. To the degree a government reaches a sufficiently high level of assets and expertise, it may will be willing to incur somewhat larger administrative costs in return for greater control of asset management.

In states that are not offering local governments access to a pooled OPEB trust, state county associations may be able to offer this service. Several county associations already manage retirement trust funds on behalf of members, and it may be helpful to offer a similar service for OPEB trusts.

One final area that county associations may want to consider is offering OPEB and financial management consulting services. Using their knowledge of local government law, the associations could provide needed help to counties on an as-needed basis, either individually or through group training. Offering a trusted and eas-

ily accessible expert in these areas which are increasingly complex could be a valued service to smaller counties.

CONCLUSION PART I

This overview of GASB 45 has sought to offer readers a basic introduction to the accounting statement and the decisions and issues surrounding its implementation. We drew most of our information from interviews with staff members and elected officials from 15 counties located across the country. We supplemented the interviews with academic and practitioner articles and presentations. What was particularly striking about the interviews was that, although final implementation decisions differed across the counties, much of the advice for implementation was similar: start the process early, be open to new ideas, communicate with stakeholders, etc. The advice from interviewees was integrated into an overview of a GASB 45 implementation process which included obtaining an actuarial valuation, creating an implementation plan, managing OPEB liabilities and health care, funding OPEB liabilities, managing assets, and communicating with stakeholders. We also briefly discussed possible roles for external organizations such as state governments and state county associations. The diversity of choices in managing and funding OPEB liabilities demonstrates that there is no one best way to cope with the consequences of GASB 45, yet the goal is the same: effectively managing the government’s limited resources to achieve the greatest good. To see how our profiled counties are working to meet that goal, we invite you to read the next section.

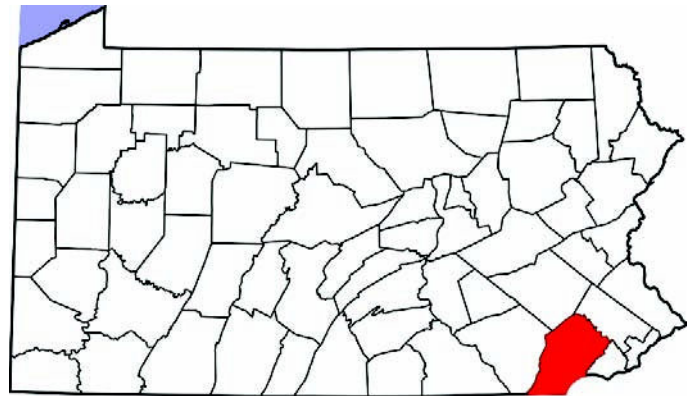
COUNTY PROFILES

The following county profiles seek to provide informative and interesting examples of how counties across the country are managing GASB 45 and their associated long-term OPEB liabilities. As you read the following profiles, you will discern a variety of policy decisions in the areas of health benefit provision, Annual Required Contributions (ARC), trust fund development, and communication with elected officials, employees, retirees and the public. These county profiles serve as a learning tool and should not be perceived as critiquing which counties have implemented GASB 45 “the best.” Rather, readers can see how different political and cultural environments, financial structures, and staff involvement result in different solutions to a common concern: balancing retiree and employee health care with a government’s financial responsibility to the community. We hope the reader can perceive some aspects of his or her own county in reading those profiled here, thereby creating ideas about what actions might best apply when addressing GASB 45 concerns at home.

In reading the profiles, one can appreciate the uniqueness of each county’s story. The profiles attempt to highlight these differences in order to better demonstrate the spectrum of approaches and challenges facing counties when implementing GASB 45. There was no universal application to facing OPEB liabilities or to viewing ARC funding. Some counties amended their retiree benefit packages; others did not, and those that did made different choices. A few governments have fully funded their ARC for FY 2008, while others are still evaluating alternatives. Similarly, several counties have created or are in the process of creating irrevocable OPEB trusts, while others are taking a different approach, and in all cases, the decisions of officials and staff reflect thoughtful consideration of the needs of their governments. County representatives were given the opportunity to review and comment to ensure the accuracy of their county’s profile.

If you are not familiar with GASB 45 and the terminology and acronyms commonly used to describe the statement, we highly recommend you read the *Background: Governmental Accounting Standards Board and Statement 45* section of this report. For brevity, the profiles assume the reader already is familiar with the accounting lexicon.

CHESTER COUNTY, PENNSYLVANIA



AAL 12/31/2006:	\$4,398,000
ARC 12/31/2006:	\$647,000
Discount rate:	5%
Population 2006:	482,112
FTEs FY 06:	2,290
General Fund FY 06: ¹⁵	\$133,756,255

Chester County decided to eliminate its retiree health-care benefit in response to GASB 45 (grandfathered current retirees). Subsequently (in 2006), the County received an Aaa bond rating from Moody’s Investors Service. Many factors contributed to the rating, however; Moody’s Investors Service cited the County for having solid financial operations supported by strong fiscal policy.

Retiree Health Plan Snapshot

- Retire after June 30, 2006: Retirees receive \$5,000 life insurance benefit, but no health-care benefit. One exception applies to members of the detectives’ union. Under the current contract, County will pay 50% of health care insurance premium for eligible members of the union hired on or before July 20, 2006 until eligible for Medicare.
- Retire before June 30, 2006: County contributes 50% of health insurance premium until eligible for Medicare at age 65.
- Plan includes prescriptions.
- Retirees do not have access to dental or vision plans.
- 3 health plans: 1 self-insured plan (PPO) and 2 fully insured (POS, HMO).

Implementation

After becoming aware of GASB 45, the County wanted to limit its exposure and act in manner that would have the least impact on

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taxpayers. Ultimately, the County eliminated the health-care benefit for employees retiring after June 30, 2006. Concurrently, the County offered a voluntary retirement incentive program.

Employees retiring before June 30, 2006, had to meet the following criteria:

- Age 55 with at least 20 or more years of credited service;
- Age 60 with any number of years of credited service;
- Before age 55 with 20 years of credited service, with a reduced pension benefit.

The County would provide the health-care benefit described above.

Employees retiring between July 1, 2006, and January 5, 2007, under the voluntary retirement incentive program had to meet the following criteria:

- Age 55 or older with a minimum of 10 years of credited service;
- Any age with 30 or more years of credited service.

Eligible employees retiring during this period received a 25% increase in service years for their pension, but would not receive the health-care benefit.

The two options allowed employees nearing retirement to choose a program that served them best depending on their age and years of service (i.e., how close to Medicare eligibility). The timing of the voluntary retirement incentive program helped lessen the impact of employees' concerns about the change in post-employment benefits.

Under the previous system, employees retiring had to meet the following criteria to be eligible for the health-care benefit:

- Elect to retire at age 55 or older, but prior to age 65, with a minimum of 8 years of continuous service
- Receive a monthly pension check under the County retirement plan sufficient to pay 50% of the monthly premium and be enrolled in the health-care benefits plan

Since the benefit ended at age 65, most employees received the benefit for a limited number of years, which kept the PAY AS YOU GO costs at a fairly reasonable level for the County. Retirees did not object to the change because their benefits were protected (grandfathered).

The County Commissioners and senior management understood the impact of GASB 45 on the County's government-wide financial statements and responded to GASB 45's implications. The

actions set forth were viewed by the Commissioners and senior management as being fiscally responsible to the taxpayers.

County members of the detectives' union hired on or before July 20, 2006, are still eligible for the health-care benefits. However, the County's liability will be small. The union has only 14 active members.

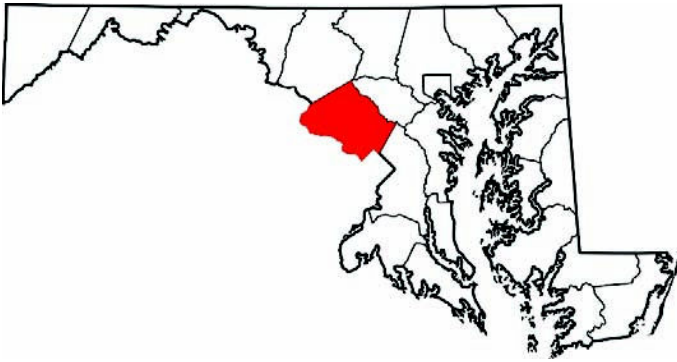
The County encountered few problems with the accounting aspects of GASB 45. By changing the retiree health-care benefit, the County realized its liability would not fluctuate greatly in subsequent years. The mechanics of implementation were fairly straightforward. However, the County staff spent a modest amount of time understanding the statement and the impact of the accounting rules on the County's financial statements. The County staff educated themselves about GASB 45 by attending seminars and reading professional publications on the subject.

The County has been able to forego a few of the more difficult funding components of implementing GASB 45. First, the County will not have to create an irrevocable trust because long-term liabilities have been essentially eliminated. Second, the County will continue with PAY AS YOU GO (\$645,060 in 2006) to fund its ARC because future liabilities going forward are expected to be minimal. For the year ended 2006, the difference between PAY AS YOU GO and the ARC was only \$1,970, meaning that the ARC was funded at 99.7%. Furthermore, the County's liability will decrease over time as current retirees age and become Medicare eligible.

The County uses a health-care consultant who recommends and reviews the latest trends in health care coverage. This cost-saving measure provides relevant information to enable management to make informed decisions about health care costs. The County used the consultant's actuary for its OPEB valuation.

The decision to change retiree health-care benefits is an example of the County's effort to effectively manage health care expenditures and balance the needs of the stakeholders within the County.

MONTGOMERY COUNTY, MARYLAND



AAL 2008: ¹⁶	\$2.6 billion (all county-tax supported agencies) ¹⁷
ARC 2008: ¹⁸	\$240 million (all county-tax supported agencies)
Discount rate: ¹⁹	7.5% - 8.0%
Population 2006:	932,131
FTEs FY 06: ²⁰	9,089
General Fund FY 06: ²¹	\$2,438,397,555

In Montgomery County, staff from several agencies coordinated early GASB 45 analysis and consistent implementation of funding plans, which improved the clarity of the OPEB standard for elected officials.

Retiree Health Plan Snapshot

- *Hired after 1987:* County pays between 50% - 70% of premium for life. Percentage increases by 2% with each year of service. Minimum 5 years of service and maximum benefit reached at 15 years.
- *Hired before 1987:* Above benefit or can opt for County paying 80% of premium for same number of years after retirement as years of County service. At end of cost share period, retiree responsible for 100% of premium amount. Example:

16 Data is as of June 30, 2006, for use in FY08 budgeting.

17 County tax-supported agencies with their own OPEB plans include: Montgomery County government, Montgomery County Public Schools, Montgomery College, and the Montgomery County portion of the Maryland-National Park and Planning Commission; the Washington Suburban Sanitary Commission has its own OPEB plan, but the Montgomery County portion of its costs are not included above as it is not a tax-supported agency.

18 Data is as of June 30, 2006, for use in FY08 budgeting.

19 Discount rates vary by agency depending upon pension plan rate assumption.

20 Employees are for Montgomery County government only; If the employees of the other agencies are included, FTEs would be 31,960.

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if work for 20 years will receive 20 years of cost share with County.

- Health plans include medical, dental, vision, and prescription (dependent coverage is also available)
- Life insurance, including optional life insurance for dependents, is also available
- Retiree can drop coverage with County yet remains eligible for coverage at a future date if desired. Goal to avoid unnecessary County coverage, and therefore cost, for retirees having second careers
- County medical plans becomes secondary to Medicare when retiree reaches 65
- Medical plans include 3 self-insured plans (2 POS and 1 HMO) and 1 fully insured plan (Kaiser)

Implementation

The Montgomery County Council approves funding through separate budgets for the County's general government and three other major organizations that have their own OPEB plans: Montgomery County Public Schools, Montgomery College, and the Montgomery County portion of the Maryland-National Capital Park and Planning Commission; the budget of the Washington Suburban Sanitary Commission, which also has its own OPEB plan, is subject to bi-County (Montgomery and Prince Georges) approval. Montgomery County's operating budget includes expenditure information not just on the upcoming fiscal year but projections for five additional years. Therefore, for the Council to make educated decisions when planning for appropriating OPEB funding, officials needed to know the relative liabilities of each organization; officials also wanted to ensure as much consistency as possible relating to actuarial methodologies and assumptions. In order for OPEB liabilities to fit into this fiscal planning philosophy, as noted below, the County conducted their first valuation quite early, in 2003. The early high-level projections enabled the County to disclose its OPEB liabilities in its fiscal plan.

To ensure that the County was identifying and addressing the potential impact as early as possible, the County Council hired an external actuarial consultant and the County agencies formed a multi-agency OPEB workgroup while the GASB standards were still in an exposure draft stage. Each agency ensured that the workgroup included representatives from both fiscal and OPEB plan administration areas. For Montgomery County government, this included representatives of the Office of Human Resources, Department of Finance, Office of Management and Budget, and later the Office of County Attorney and Board of Investment Trustees for the pension plan. The County agencies conducted their first high-level valuations in 2003. The agencies hired one firm to perform the valuation, which, while recognizing that each agency had

its own OPEB plan, helped ensure consistency in methodologies and assumptions.

The multi-agency OPEB workgroup has continued its efforts over the last several years, with most recent focus on full and complete baseline actuarial valuations for each agency as of July 1, 2006. As part of its normal operations, each agency worked with its own actuarial firm; two firms were involved across all agencies; the Council's external actuarial consultant has continued to participate in these efforts. Staff believes these ongoing interactions between the departments, across agencies, and with all actuaries, have been successful and improved the County's valuation and decision-making on key issues surrounding GASB 45.

Having comparable full actuarial valuations then became one of the important next steps for all the organizations. Comparability required all the organizations to use the same methodologies and actuarial assumptions (e.g., discount rate) whenever possible and where appropriate. Ensuring consistent methodologies can be extremely challenging and time consuming, since some differences may not be readily apparent to the government. Identifying any differences in assumptions (i.e., discount rate, amortization method) and ensuring the differences are valid and appropriate was also critical. The agencies have also developed a compatible implementation plan – a five year phase-in to full prefunding of the annual required contribution. This level of coordination has taken a considerable amount of staff time but the actuarial valuations are much more valuable as an information tool and have greatly increased clarity about OPEB liabilities for the County Council and the general public. It should also be noted, however, that differences in benefits and eligibility between plans affect the valuations and therefore contribute to the challenge in trying to make comparisons across organizations.

The County has experienced cost increases in recent years, not inconsistent with industry trends. In 2005 and 2006, health care costs rose by 12.9% and 10.4%, respectively. The change was less for 2007 at 6.0%. In light of growing health care costs, the County is exploring different options to reduce cost.

The County Council approved a resolution to phase in full-funding of the ARC over a 5 year period. The amount of additional funding each year equals an amount that is 1/5th the difference between PAYGO and the ARC. For FY 2008, the budgetary impact is \$38.9 million which includes \$31.9 million for the OPEB phase in obligation and \$7 million related to increased PAYGO costs.²² The County believes that the steady ramp-up of the ARC payment

will be viewed favorably by the credit rating agencies and that the County's AAA rating will not be impacted.

Revenues dedicated to the ARC will be deposited into irrevocable OPEB trusts, formed for each agency, which from GASB's perspective is another positive sign for addressing OPEB liabilities. It is anticipated that a new board of trustees will oversee the County trust.

By seeing the actuarial valuations, the County could one, better appreciate the importance of GASB 45 and two, better understand the linkage between changes to pension benefits (e.g., early retirement) and their impact on OPEB liabilities. The current Council president also took an early interest in OPEB, helping to engage others. Since the County has a fiscally conservative culture, Council members wanted internal and external stakeholders to understand that OPEB was not just an accounting exercise but had real fiscal impacts on County finances.

Like the coordinated approach the County established for its actuarial valuation, the County developed a communication plan for GASB 45. The purpose of the communication plan was to ensure a consistent message and thereby reduced confusion about GASB 45 and the County's implementation plans for employees, retirees, and the general public.

Two very important groups of stakeholders for GASB 45 in Montgomery County are retirees and the unions. Approximately 70% of County employees are represented by one of three unions. Two unions represent active police and firefighters, respectively; another union represents active sheriffs and correctional officers, as well as active general government employees. Benefits (retirement and group insurance) are subject to collective bargaining and the County negotiates with each union separately. Retired employees are not represented by a union, but the County does communicate with the retired employee association on benefit issues.

County staff coordinated with the County retiree association so that members would have accurate information on the accounting statement. The County also involved its Public Information Office, as part of these efforts, to help ensure the understandability of County communications.

Finally, the County is creating a GASB 45 web-link from the County's website. All the information will be strictly fact based. The key link would be from the Finance Department but other departments and agencies can link where appropriate as well. The website will contain all GASB 45 documents such as actuarial reports, Council-approved legislation, etc. for interested persons to read directly. The website will include a general overview (i.e., ex-

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ecutive summary) and FAQ’s that the readers can click on in order to learn more detailed information.

Though pleased with their progress, one area that has been slightly problematic for the County concerns the limited legal information that is available for implementing GASB 45. This issue has posed problems for other first-phase implementation counties as well. Jurisdictions, such as Montgomery County, who are on the leading edge of implementing the new standard, have little “lessons learned” to draw from and are often the first to raise certain issues with GASB and GFOA. Smaller counties can significantly benefit by learning from larger counties like the ones profiled here.

MARATHON COUNTY, WISCONSIN



AAL 2007:	\$5 million (estimated)
Population 2006:	130,223
FTEs FY 06:	838
General Fund FY 06: ²³	\$58,600,532

As the smallest county in the study, Marathon County demonstrates that midsized counties can offer health benefits to retirees while controlling liabilities.

Retiree Health Plan Snapshot

- County contributes to employees’ individual health savings accounts; (see below).
- Qualified retirees have access to County health plan until they are eligible for Medicare.
- Retirees pay 100% of insurance premium (implicit liability only).
- General employees are eligible at age 55; public safety employees, at 50; employees must retire directly from County.
- Health plan includes prescriptions, vision, and dental.
- County is self-insured and offers one PPO plan.

Health Plan Details and Implementation

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²³ Marathon County FY 2006 Comprehensive Annual Financial Report. General Fund Revenues.

In the late 1990s, Marathon County changed its retiree health benefits, creating individual health savings accounts for employees that resemble deferred-compensation pension plans. Current employees receive contributions deposited into personal accounts; at retirement they can access this money to pay for health-related expenses such as insurance premiums. The County contributes to the accounts in two ways:

- 1) The county contributes \$12 per pay period for each employee, \$312 annually.
- 2) At retirement, employees can convert up to 1,200 hours of sick leave into a financial contribution to their health retirement accounts. Employees can receive up to 50% of the monetary value of their accumulated sick leave. The percentage is based on years of service and age. Benefits begin when an employee's score reaches above "70" and maximizes at a score of "80" with the County paying 50% of an employee's hourly wage. Every score above 70 results in a 5% benefit increase. For example, a 55-year-old employee who chose to retire after 21 years of service would have a score of 76. The benefit equation would be: $(76 - 70) \times 5\% = 30\%$ benefit. If the retiree has saved 1,200 hours of sick leave and earns \$20 per hour: $1,200 \times 30\% \times \$20.00 = \$7,200$.

The health savings accounts are managed similarly to other deferred-compensation plans and offer similar advantages to the employer. The County pays the liability as it accrues and retains no financial commitments to employees after they retire. Accounts are managed through a private company, which charges a small administrative fee, an arrangement that requires less administrative time on the part of the County. Contributions to the accounts earn interest. As an employee's years of service increase, so does the balance in his or her post-employment health savings account, including interest earned from investments. If an employee chooses to stay in the County's insurance plan after retiring, premiums are deducted directly from his or her account.

The County began its first valuation in August, 2007, and it should be completed in the fall of 2007. However, the Finance Director has estimated the County's OPEB liability at approximately \$5 million. When developing the actuarial contract, the Finance Director worked with the County's external auditor. She asked the auditor to review the actuarial assumptions for reasonableness, since the implicit liability can vary significantly based on the assumptions chosen. By collaborating with the auditor, the Finance Director not only profited from additional expertise, but also reduced the likelihood that concerns about the actuarial valuation would be mentioned in the County's annual financial report. The actuary is developing scenarios for funding the County's implicit rate liability.

Since Marathon County has provided health savings accounts for a relatively long period and has no retirees eligible for any prior benefit program, the County will carry only an implicit rate liability under GASB 45. The Finance Director was able to estimate the liability because claims made to the County health fund are coded by type of member (e.g., retirees, general employees). Because the implicit liability is so low, the County does not anticipate restructuring the health plan.

The Finance Director is considering two options for addressing the County's liability under GASB 45:

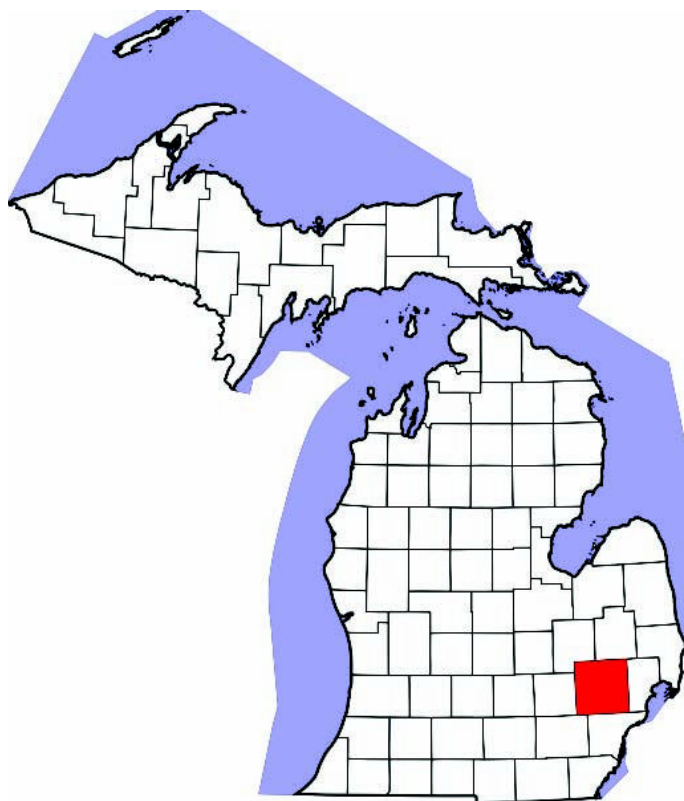
- 1) She may work with an actuary to develop health-plan design options to address the implicit-rate subsidy.
- 2) She may amend the funding formula currently used for the health insurance internal service fund. In the past, at the end of each fiscal year the County has applied approximately one-third of its unreserved fund balance to offset the next year's premiums. That money could be used to fund the implicit-rate liability instead.

The County is also likely to create a trust fund to fund future obligations. Though the details have not been finalized, the County has investment policies in place which will speed implementation of such a fund. The County Treasurer would manage the investments in cooperation with the County Board Finance Committee.

Because the County is in the early stages of GASB 45 implementation, staff have not given a formal presentation on the County's liability and funding options to the County Board. Some Board members have already become familiar about GASB 45 from attending professional meetings such as NACo. This background knowledge will be useful when the County is ready to make final decisions on creating a trust, funding the ARC, and so on. Furthermore, the Finance Director does not anticipate much employee or retiree interest in GASB 45, because the health-care account benefit is not changing, and no tax increase will be required.

Limiting long-term OPEB liabilities is reflective of the general culture of Marathon County, which is fiscally conservative and undertakes little borrowing. This culture has helped the County to avoid expensive increases in benefits even though it negotiates with several unions through a labor-management board. In sum, the elected officials and management of the County have historically limited expenditures and so are facing GASB 45 with limited liabilities and less stress.

OAKLAND COUNTY, MICHIGAN



AAL 10/1/2007:	\$829.7 million (total liability is advance funded)
ARC 10/1/2007:	\$60.2 million
COP Debt Service FY 2008	\$46.4 million
Discount rate:	7.5%
Population 2006:	1,214,255
FTEs FY 06:	4,536
General Fund FY 06: ²⁴	\$432,859,938

For the last two decades, Oakland County has been proactively addressing retiree health care costs. This perspective is demonstrated by 1) a pre-funding policy that has been in existence for 22 years, 2) redesigning their retiree health benefit, and 3) issuing OPEB debt to fully fund an existing OPEB trust.

Retiree Health Care Snapshot

- *Employees hired after December 31, 2005:* Health care coverage no longer provided upon retirement. County contributes \$1,300 annually to individual employee retirement health savings accounts. At separation, employee may use these funds

for medical purposes (as approved by the IRS). See Marathon County profile for explanation of health savings accounts.

- *Employees hired after December 31, 1994, and before January 1, 2006:* County contributes percent of premium for retiree health care. Requires 15 years of service to become vested for benefit of 60% premium subsidy. Benefit increases by 4% each year thereafter with 100% vesting after 25 years of service.
- Health benefit plan includes prescriptions, dental, and vision.
- *Employee contribution for FY 2008-PPO:* If hired after 2003, \$32 biweekly for single coverage and \$75 for family. Employee contribution if hired before 2003, \$20 and \$50, respectively. County plans to raise contribution rates again in 2009 for employees hired on or before 2003 to equalize contribution rates for all active employees, effective January 2009.
- County has 4 self-insured health plans and one premium-based plan; however, two plans (including the premium-based plan) are closed to new enrollees. The three open plans are PPO, POS, and CMM.

Health Plan Details and Implementation

Oakland County's relatively recent adoption of retirement health-savings accounts is reflective of its on-going efforts to plan for and mitigate health care expenses. Concomitant with this perspective has been an attitude of openness, and that includes communicating County plans with affected stakeholders. Executive Office staff spent considerable time educating the County Board of Commissioners about the proposed change, a process which resulted in bipartisan support for restructuring retiree health subsidies. Similarly, the County has generally found that employees have accepted health care changes after proper explanation. In preparation for the 2006/2007 and 2007/2008 budget roll-out, senior management met with employees in two-hour sessions to discuss the state and local economic landscape and the impact health care has on the overall budget. Generally, employees have been understanding of the need for the health-benefit changes, and because the bulk of the changes apply to new employees, the County has experienced little resistance from non-union workers. For unionized employees, the County has negotiated labor agreements with nearly all the unions that include the health savings accounts and higher employee health-care contributions as well. However, one bargaining group (deputies union) has moved to arbitration, and health care issues, along with a number of other items, remain unresolved.

Well before the private sector was required to use accrual accounting for retiree health-care costs, Oakland County was pre-funding its OPEBs. The 22-year commitment to use accrual instead of the typical PAYGO financing method has lasted over multiple administrations and through difficult fiscal times. These dedicated revenues are deposited into an irrevocable trust (VEBA) which is

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managed by the County Retirement Board.²⁵ As of September 30, 2006, the VEBA account had assets totaling \$303.1 million, well over one-third of the County's AAL under GASB 45 (see above). Relying on long-established investing policies and providing strict oversight of its money managers, the Retirement Board has maintained an historical investment return equaling 7.58 percent, saving the County millions of dollars in OPEB payments over the years.

Because of the cost savings gained through long-term investing, the County decided to fully advance fund its OPEB liability. Through a competitive sale in late June 2007, the County issued taxable OPEB Certificates of Participation (COPs). COPs differ from general obligation bonds because the County is not pledging its full faith and credit (i.e., taxing ability). Nor did the County include an annual appropriation promise, making the COP a trust agreement. However, the County did pledge an asset as collateral, which is expected for COPs. In this case, the County pledged the VEBA trust balance as security and earnings from investments to repay the debt. At the recommendation of their attorney, the County Board also signed a "trust agreement" affirming the contractual obligation for "core benefits" to employees. The County needed the contract to obligate itself in order to show that the County needed the COP proceeds. In other words, the Board affirmed its health care obligation to strengthen the issue. This agreement created a tenuous position for the County in that it did not want to promise too much in regards to retiree health benefits in order to retain management flexibility yet the County wanted to establish sufficient obligations for the COP issue.

Perhaps because of its AAA bond rating, the County was able to sell its COPs at a true interest cost (TIC) of 6.23%. This rate is sufficiently less than the average historical interest earnings of the VEBA trust (7.58%), which makes the debt issue financially beneficial for the County. Because COPs are taxable, the County will not be bound by federal arbitrage law that prohibits state and local governments from earning investment returns that exceed the interest rate paid on tax-free government debt. To put the savings from the debt issue into perspective, the debt service in FY 2008 will equal \$46,435,316, which is \$13.8 million less than that year's OPEB ARC. Net proceeds from the sale equaled \$557.0 million which, when added to \$303.1 million in the VEBA trust, results in \$860.1 million total assets for OPEBs, fully funding the AAL.

The debt's structure had a few components that might have affected its interest rate; however, the County felt that the need for

openness and financial security outweighed the cost. First, the bond structure included a call provision (paying off debt early) after seven years, which may have raised the TIC a bit because the standard call provision is typically longer (10 years). Second, some experts question the County's use of a competitive sale instead of a negotiated sale with an underwriter because of the issue's "newness." However, an important benefit of competitive sales is eliminating any question of political influence, whereas in a negotiated sale there may arise concerns over favoritism in underwriter selection.²⁶ The last major provision probably had no impact on the interest rate, but will help the County's financial position over time. The COPs will be repaid over 20 years rather than 30, which is the actuarial amortized liability from their OPEB valuation.

The COP proceeds have been deposited into an Intermediary fund (special revenue fund) rather than directly into the VEBA trust. The primary purposes of the Intermediary fund are to make ARC payments to VEBA annually and to accumulate investment income. After 20 years, the VEBA trust will be fully funded. Senior management felt it was important to have the Intermediary fund in case the County's VEBA trust did not require all the COP proceeds in the future. In particular, staff brought up issue of national health care. If that occurs, the County can refund the COP proceeds that remain in the Intermediary fund.

Oakland County will deposit revenue for the debt service payments into a Fringe Benefit fund (internal service fund) rather than having those paid from the Intermediary fund. Revenues for debt service will come from charging an OPEB fee to each County fund (e.g., General Fund, enterprise funds), thereby ensuring all revenues sources contribute to repaying the OPEB debt. For FY 2008, the County has budgeted \$46.1 million for the ARC, so the bond payments have already been built into the operating budget. In other words, the County's various funds will not have to find significantly more revenue in the future to repay the COPs. Under the current 20- year debt repayment schedule, the highest bond payment is \$49.6 million, only \$3.5 million higher than what is already budgeted.

The County had originally planned to issue general obligation (G.O.) bonds rather than COPs because the former would have resulted in lower interest rates. Unfortunately, the County was unable to receive authority from the State to do so. The State Legislature passed a bill authorizing Oakland to issue OPEB G.O. bonds, but the Governor vetoed the legislation in January of 2007. The stated reason for the veto was to protect the State from decreased federal Medicaid reimbursements. Senior County management es-

25 The Retirement Board is composed of 9 members: County Executive, County Treasurer, County Board Chairperson, Chair of the County Board's Finance Committee, 3 representatives elected by employees, 1 retiree elected by retirees, and 1 citizen appointed by the County Board.

26 Shields, Yvette. July 2, 2007. *Oakland County COPs Get One Bid*. The Bond Buyer www.bondbuyer.com

estimate that selling COPs rather than the more secure G.O. bonds combined with the resulting issuance delay from restructuring the debt issue, cost the County approximately \$78 million in higher interest payments.

The County Executive and senior management put extensive effort into explaining the COP to the County Board, the public, and employees. Senior management gave presentations on the debt issue to the County Board and worked extensively with the Board's Finance Committee. As stated earlier, the County Board supported the sale, even approving a resolution. To get the public's attention, staff wrote newspaper editorials, drafted articles, and posted materials on the County's website, including a "Frequently asked Questions" page. However, the County found little public interest in the COP, probably because property taxes were unaffected. County employees were supportive of the issue, which makes sense since the issue would help to guarantee future funding for their health-care benefit.

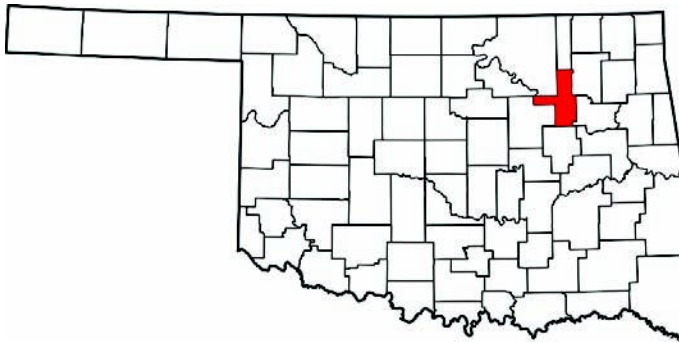
In addition to issuing the COPs and creating employee health savings accounts, the County has undertaken several other efforts to reduce health-care costs. These include reviewing health plan designs, initiating voluntary buyouts of the retiree health benefit from current and former employees, and establishing an extensive wellness program. The County hired a health benefit consultant to assist staff in reviewing health plan designs for new hires, active employees, and retirees. Plan-related cost-savings initiatives also included competitively bidding the prescription drug program and raising insurance co-pays. One important selling point for the voluntary buyouts of the defined health benefit has been the health savings account's portability. Employees who have vested benefits, but do not plan to retire with the County, can take their health saving account assets with them regardless of where they ultimately retire. Or if they have earned another retiree health-care benefit from other employment, they can use the account in conjunction with the second benefit. These initiatives have generally been successful though with vary degrees of impact but also requiring different levels of effort.

The County has invested substantial resources into its wellness program in hopes of reducing health care costs over the long term. The County has already appropriated \$400,000 for the program in addition to substantial staff time from the Human Resources Department. The County implemented its wellness program in phases, beginning with increasing awareness. Employees can now go to the County website for information about healthy living (research, cookbook, etc). Furthermore, the HR Department organized a multi-departmental wellness committee charged with creating programs that combine the resources and skills of the entire County, such as staff from Cooperative Extension, Sheriff's Office,

and Public Health. Through this multi-departmental effort, the HR staff hope to encourage more diverse participation, believing that an employee may be more willing to join a program if he or she sees a colleague significantly participating. Another initiative includes a quarterly commitment program that encourages healthy habits like smoking cessation and exercise. For example, Weight Watchers will come to County offices for weekly meetings during the lunch hour. Finally, the County recently offered confidential health screenings for early diagnosis (and treatment) of chronic diseases, like diabetes. To encourage participation, employees received \$100 if they took the screening tests and completed a survey. The project was extremely successful, with 46% of employees attending the screening. HR staff are currently processing and analyzing that data to determine the next steps for the wellness program. In the future, the County would like to expand its wellness program to retirees by increasing the education component and encouraging participation in other wellness activities.

Throughout the GASB 45 implementation process, the County used a team approach that included extensive communication among executive departments and the County Board. The Executive Office, Budget, Human Resources, Attorneys, and Retirement Board collectively organized the COP debt issue. Human Resources and Budget worked jointly to implement the retiree health saving accounts. Executive staff advised the Board on the economics of GASB 45, retiree health care, contractual obligations to the unions, the COP issue, etc. The Retirement Board works closely with the County Board's Finance Committee over the VEBA annual report. Individually, these changes have taken considerable time and political will, and together they demonstrate a strong commitment by Oakland County to meet the fiscal challenges faced from OPEBs and GASB 45.

TULSA COUNTY, OKLAHOMA



AAL 2007: Less than \$700,000
 Population 2006: 577,795

Due to the nature and structure its post-employment health benefit, Tulsa County has a very modest OPEB accumulated actuarial liability. However, one issue that the County is currently grappling with is the mechanics of addressing its implicit-rate subsidy.

Retiree Health Plan Snapshot

- County contributes to employees' individual health savings accounts; (see below for details).
- Non-Medicare eligible retirees have access to County health plan, but retirees pay 100% of insurance premium. Health plan includes prescriptions.
- Retirees pay higher insurance premium than active employees.
- Medicare-eligible retirees participate in separate, Medicare Supplement insurance plan. Retiree pays 100% of insurance premium.
- County has separate plans for vision and dental. Retirees may participate in plan but pay 100% of insurance premiums.
- Employees vested with health savings accounts after 5 years of service.
- County is currently fully insured, but anticipates moving to self-insurance health plan next year.

Health Plan Details and Implementation

The County has structured its health benefits to limit future liabilities and permit financial flexibility. A few years ago, the County Board established two accounts to pay for post-employment health care. The County sets aside 2 percent of an active employee's pay plus \$25 a month per employee into the accounts. At this point in time, the accounts have balances totaling approximately \$12 million. Revenues for the accounts are invested and earn interest for the employees as well.

Though the money sits in two large county accounts, the revenues belong to individual employees for post-employment health benefits. In other words, the benefit works as a true defined-compensation plan. As an employee's years of service increase, so does the balance in his or her post-employment health-care account. By using defined dollar contributions (\$25) instead of a percent of salary, the County has tried to address the needs of lesser-paid workers. Like all defined-compensation plans, the County pays the liability as it accrues and retains no financial commitments to employees after they leave the County. Accounts are managed through a private company, which charges a small administrative fee. After leaving the County, the former employees can use money in their accounts only for health-care-related costs like insurance premiums or co-pays. Employees have limited control over how individual accounts are managed (i.e., choosing from a small array of mutual funds).

The County has also structured its health insurance plan so that its accrued liability is limited. First, though the County currently allows retirees access to their health plan, no written agreement exists promising retirees the option of purchasing health insurance from the County after retirement. Second, to address claims-cost differences between active employees (who are typically healthier and therefore less expensive to insure) and retirees, the County assesses retirees a higher insurance premium. This insurance premium differential has resulted in the County's having a relatively small implicit rate liability under GASB 45.

Furthermore, Tulsa County benefits from a political and work culture that has kept the OPEB liability low. In Tulsa and Oklahoma generally, employees work until age 65, and many employees have 20-30 years of service with the County, even though they are vested with the retirement system after five years. As a result, there are relatively few Tulsa County retirees; however, the County anticipates a growing number of retirees over the next few years (i.e., baby boomers). County law enforcement personnel are also exempt from state statute that permits 20 years of service to qualify for full-benefits/retirement, thus encouraging this class of employees to work well into their 50s and 60s. State law prohibits state and county employees from unionizing as well.

The biggest issue facing the County at this point is deciding how to address the AAL, which is only due to small implicit rate subsidies. The County is hesitant to establish an irrevocable OPEB trust because of uncertainty about whether the government would ever be able to draw down the funds.

The County is considering applying the \$12 million balance in its health savings accounts as an asset, thereby completely offsetting the \$700,000 AAL. The County would prefer not to have

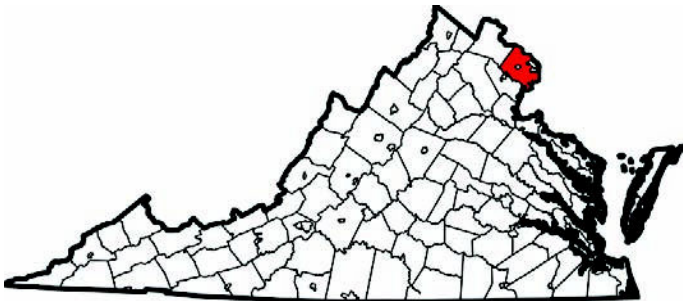
any liability from the implicit-rate subsidy and to keep the \$12 million “off the books,” because the County sees the health savings accounts as being fiduciary in nature. However, if GASB and the County’s external auditors believe Tulsa must to post the \$700,000, then the government would like to have the \$12 million posted as well in order to eliminate any liability.

Because the OPEB liability is so small and the real concern for Tulsa has been about the mechanics of the statement, Tulsa’s actuary has spent his time assessing GASB 45 implementation requirements, learning the rules so to speak, rather than developing ARC funding scenarios, as has been the case for the majority of the counties this study profiled. Like the other counties, Tulsa considers the actuary a partner in implementation.

Because the AAL is so small and the County does not plan on altering either the health benefit or its insurance premiums, the need to share a great deal of information about GASB 45 is limited. The Finance Director presented information about Tulsa’s AAL and GASB 45 to the Tulsa Budget Board and will return to them when he is sure of all the financial disclosure and financing alternatives. County employees and retirees have shown little interest in GASB 45.

By providing a defined-compensation post-employment health benefit and by adjusting insurance premium rates according to employment status (active vs. retired), the County has incurred a very small OPEB liability. For counties concerned about long-term liabilities, but still wanting to offer retiree health benefits, Tulsa County may be an interesting example.

FAIRFAX COUNTY, VIRGINIA



AAL 2006:	\$143,321,000
ARC 2006:	\$15,196,000
Discount rate:	\$7.5%
Population 2006:	1,010,443
FTEs FY 06 ²⁷ :	10,999
General Fund FY 06 ²⁸ :	\$3,068,308,999

Fairfax County staff approached GASB 45 as an opportunity to learn about health care, about irrevocable trusts, about communication, and finally, about the benefits of building strong relationships inter-organizationally. This attitude will undoubtedly aid the County as it continues through the GASB 45 implementation process and as it manages OPEBs over time.

Retiree Health Plan Snapshot

- County provides fixed monthly stipend to retirees. Benefit is based on combination of years of service and coverage category (retiree-only or retiree plus dependents). In 2007, maximum stipend equaled \$220 per month, about 75% of premium.
- Stipend decreases once retiree qualifies for Medicare.
- Health plan includes prescriptions.
- Retiree pays 100% of dental (implicit subsidy only).
- Retiree must participate in health plan upon retirement from County in order to get stipend.
- County has three self-insured plans and one fully-insured plan.
- County provides a life insurance benefit.

Implementation

Though implementation was extremely time-consuming, staff faced GASB 45 as a positive challenge and a collaborative effort. Being assigned as the County’s lead agency in implementation, the

27 Excludes employees for Fairfax public schools, Housing and Redevelopment Authority, and the Park Authority

28 Fairfax County FY 2006 Comprehensive Annual Financial Report. General Fund Revenues

Finance Department quickly realized it needed a strong partnership with the Human Resources Department (HR) to learn about health-benefit administration. Concomitantly, HR needed to examine how OPEB changes affected long-term liabilities for all future benefit adjustments. Furthermore, funding recommendations for accrued OPEB liabilities were to come from the Department of Management and Budget, so their input was critical as well. By learning from other departments, staff feel confident they can soundly address the long-term impacts of GASB 45.

Wanting to be prepared, Fairfax conducted its first actuarial valuation in 2005. After getting over the “shock and awe” of the liabilities figures, Finance staff quickly moved into action and developed an implementation plan. One of their first efforts was to educate senior county management about GASB 45 so that all parties would be on the same page going through the implementation process.

One significant plus for the County has been the HR Department’s on-going efforts to control expenditures. The HR Director believes that an important element in controlling costs is to view health care as a system and not simply as an accounting exercise where individual claims are paid. Rather, local governments need to appreciate the costs associated with the entire system and create incentives and controls that limit system costs, such as regularly bidding the administrative contract or creating wellness programs. This “systems approach” is evident in the County’s creation of a strategic plan for employee benefits. With so many competing fiscal demands on the County, the HR Director recognizes that new money for health care will be hard to find, and thus that his office needs to maximize cost effectiveness. The strategic plan articulates where the savings should come from and be distributed: maintaining benefit levels while minimizing premium increases. Because the County already had in place a plan for health-care benefits that addressed long-term expenditures, the County did not feel the need to change benefits because of GASB 45. However, the County has reserved the right to change OPEBs in the future, clarifying the County’s prerogative in personnel and financial documents.

The County offers a blended health insurance premium, meaning that plan members pay the same premium regardless of employment status (i.e., active employee, retired), though they will pay different premiums if covering a dependent. Therefore, the County has implicit rate liability under GASB 45. Because the County’s health insurance OPEB is a fixed stipend which shifts liability for premium increases to the retiree, the implicit subsidy has a real benefit in that the retiree’s premiums are subsidized by less expensive plan participants. However, the blended premium comes at a cost to the County as well. For Fairfax, the 2006 actuarial valuation for the explicit medical subsidy equaled \$77.6 million and the im-

PLICIT medical subsidy reached \$58.0 million (7.5% discount rate). In other words, the implicit subsidy was nearly 75 percent of the explicit subsidy. Because Fairfax knew the value of the implicit-rate subsidy from its actuarial valuation, it was able to evaluate alternatives, like rate adjustments, realistically. Fairfax County illustrates how important understanding the costs of an implicit-rate subsidy can be.

Freed from concerns over amending retiree health benefits, the County has been able to focus its attention on two areas: funding the ARC and creating a trust. Fairfax decided not to establish a formal fiscal policy in funding the ARC because it wanted flexibility in annual expenditure allocations. Again to avoid a fixed liability, the County decided against issuing OPEB bonds. However, the County believes funding the ARC is important and has set aside one-time revenues (\$48.2 million) that funded the FY 2008 ARC. Overall, County management believe that figuring out how to fund the ARC has been the most difficult aspect of GASB 45 compliance.

The FY 2008 ARC monies will be deposited into an OPEB irrevocable trust for investment. However, even gaining the authority to establish a trust took many hours of work. When the Finance Department researched Virginia statutes and learned the County did not have authority to create an OPEB trust, staff took the initiative and decided to craft legislation establishing local government authority. The Finance staff worked the State Auditor and the County’s local state legislator throughout the legislative session, and the bill passed in 2007. The new law is geared to all local governments (i.e., cities, schools) in Virginia, not to Fairfax alone, and offers several options for managing an OPEB trust.

Because the law does offer several alternatives for oversight and fund management, the Finance Department and County senior management are in the processing of deciding which method to adopt and will then submit the proposal to the Board of Supervisors for approval. To help with the trust language, the County hired a legal firm with expertise in this area. Staff anticipate the trust being established by fall 2007. The County believes that establishing an irrevocable trust demonstrates its commitment to meeting its liabilities under GASB 45.

When thinking about the trust and its benefits and limits, staff quickly appreciated the benefits of investing ARC payments over the long term. The actuarial valuation gave two AALs -- one with a 3.0% discount rate and another at 7.5% (listed above). The 3.0% rate assumes the County invests ARC funds only in short-term instruments like certificates of deposit, much like a government’s General Fund, while the 7.5% rate equals the investment returns from its pension trust fund. The AAL and ARC at a 3.0% discount

rate was more than double (\$310.6 million and \$27.3 million, respectively) than when using an irrevocable trust. See AAL and ARC above. However, when considering the best discount rate to use for the actuarial valuation, the County felt it very important to assign a reasonable and achievable investment return/discount rate, and its final valuation will use a 7% discount rate. The County eschewed an aggressive rate, recognizing that it would need to pay OPEB liabilities regardless of any predicted actuarial cost, and it was better to have set aside sufficient revenues than to “ARC shop” by choosing an actuary who would give the highest discount rate. This conservative investing philosophy is shared by all the counties in the study.

Throughout the GASB 45 compliance process, the County was very cognizant of the need to maintain its AAA credit rating. The Chairman of the County Board of Supervisors and senior management met with the rating companies to discuss the County’s progress with GASB 45. The Chairman’s participation signaled to rating agencies the County’s commitment to meeting its financial obligations. Based on these meetings as well as from pronouncements, County staff believe that the rating firms will expect AAA governments to manage their liabilities, but will also understand if an ARC is not fully paid in any one year due to budgetary constraints. The keys to maintaining a strong credit rating will be that the government has enacted a funding plan, has controlled costs, and has showed a track record of meeting its ARC. Of course, credit ratings are based on numerous factors, and paying for the ARC is just one. By over-funding the ARC for FY 2008 and creating an OPEB trust, the County thinks it has acted to ensure that its credit rating will remain unchanged.

Fairfax staff have actively communicated the County’s actions for GASB 45 to the County Board, retirees, and the general public. Unlike other communities where the press has not expressed much interest in GASB 45, staff faced a very politically engaged populace and regularly discussed GASB 45 and the County’s response to it. The County presented information at community groups, public meetings, and professional conferences. Meetings were also held for the County retiree association and for current employees, with some groups being more active than others, and some wanting assurance that the County was not planning on ending their OPEBs. Staff talked to retirees not only as beneficiaries but also as taxpayers, explaining to retirees that a fee-based program with assets invested through a trust will ultimately save them money. In sum, the County wanted stakeholders to understand that staff were accessible and would be open about County actions.

Like many communities, the Board of Supervisors had never heard of the GASB organization prior to Statement 45. Staff’s first step was to educate the Board about the accounting rule and then

moved to translate accounting numbers to something tangible, like the credit rating. In the future, the Board will be able to more fully evaluate the impacts of increasing benefit levels by knowing the long-term costs of OPEBs through the AAL, when responding to requests from retirees and employees.

The Board’s education took different forms. Staff met individually and collectively with Board members to discuss the County’s liability and GASB 45. Senior management always participated in the meetings with elected officials as a way to express the importance of the issue and their support for Finance staff’s work. Unlike other communities, Fairfax used their actuary in communicating GASB 45 to the Board. The County found the actuary helpful in simplifying information for lay persons. The time spent with the Board was well worth it; the members have fully supported staff’s work on GASB 45.

When asked what they learned from GASB 45, County staff offered many thoughtful responses, which aptly indicate what key decisions and processes a government will face when implementing the new accounting rule. Some of their paraphrased responses follow.

“I learned that there are different perspectives about OPEBs and that GASB 45 is not all about the numbers. I see how Human Resources affects budgeting and accounting.”

“I learned how the County can identify different opportunities for funding long-term commitments with investments; I better appreciate the power of savings.”

“I learned the process of setting up a trust.

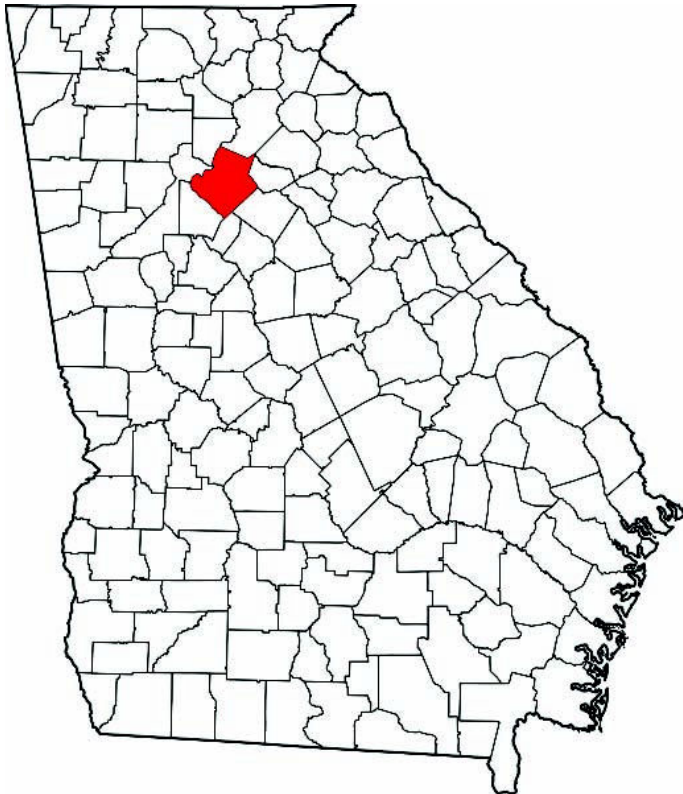
“I learned about politics through working with the Legislature to pass trust legislation.”

“I better appreciate the benefits of creating multi-agency committees and forging great relationships.”

“OPEBs are more expensive than the County originally thought. The implicit rate is more expensive, too.”

“I learned about the power of GASB. These accounting rules have tremendous impact on the policies of local government. One should not take the statements lightly.”

GWINNETT COUNTY, GEORGIA



AAL 1/1/07:	\$139.84 million
ARC 1/1/07:	\$13.56 million
Discount rate:	6%
Population 2006:	757,104
FTEs FY 06:	4,586
General Fund FY 06: ²⁹	\$396,042,000

Of all the counties profiled, Gwinnett County has undertaken some of the most significant changes to its retiree-benefit structures in the last two years. Some of the changes were a matter of growth and a natural progression, while others were spurred by GASB 45 and the information learned from implementing the statement.

Retiree Health Plan Snapshot

- Recently changed from a defined-benefit plan, where County paid percent of health insurance premium, to a set monthly contribution.
- Health plan includes prescriptions.
- Retiree pays full premium for dental and vision, but can access County's group plan (implicit liability only).

- Vesting of health benefits after 10 years of service, must retire directly from county.
- No age limit to begin receiving retiree health benefits.
- Benefit contributions decrease once employee and/or dependent is eligible for Medicare.
- County offers self-insured plans (HDHP and HMO) and one insured plan (Kaiser).

Implementation

Gwinnett has been able to implement many changes to its retirement benefits because it began preparing several years earlier for GASB 45. The county undertook its first actuarial valuation in 2002 and has already updated it three times. To help keep the County on track with implementation, the County Administrator directed the Department of Financial Services in 2006 to create an OPEB funding plan as a departmental annual goal, which is published as part of the budget. The Department wrote the policy, and the County Administrator approved in May 2007.

From the beginning, the Department of Financial Services and County Administrator worked to keep County Commissioners abreast of GASB 45 and the County's OPEB liability. By having the actuarial valuations, staff could explain OPEB liabilities and the impacts of changing the funding mechanism in concrete terms. The Commission also passed a resolution supporting full funding of the County's ARC in 2007. Of course, it helped that the Commission, County Administrator, and Finance Director already had strong relationships built on trust.

In addition to educating and fully informing the Commission about GASB 45, the Director of Financial Services wanted to ensure that the County's other department directors understood the basics of GASB 45, too. First, as employees themselves and as supervisors of other employees, directors were reasonably concerned about the future of retiree health benefits. More important, department directors provided a communication linchpin to employees, and their understanding and support of County policies were very important for ultimately achieving employee acceptance of funding changes. The Department of Financial Services also kept the Human Resources Department regularly informed of progress in GASB 45 implementation.

After looking at the January 1, 2006, actuarial figures, which showed a \$328 million AAL and a \$34 million ARC (6% discount rate) for their defined-benefit retire health care program, the County realized that its long-term liabilities were not sustainable, particularly for this fiscally conservative area. The Director of Financial Services and her staff began working with their actuaries to find a fair outcome that met the dual goals of continuing to

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 29 Gwinnett FY 2006 Comprehensive Annual Financial Report, pg. 37. General Fund Revenues

provide high quality health-care benefits to retirees and of funding their ARC.

The Department of Financial Services, which includes a Risk Management Division that administers health benefits, worked closely with its actuary throughout GASB 45 implementation. The County chose the actuary that also worked on its pension valuation because the actuary could use data from that valuation for the OPEB trust. Setting the actuarial assumptions for the valuation was a cooperative process between the County and the actuary, and though the process was very helpful in ultimately deciding on a funding strategy, it also required the Director of Financial Services to fully understand all the assumptions. The Director also found it very important to have an actuary that would work with her, such as providing impacts of proposed changes to the health insurance plan. Furthermore, it was important that the actuary had the communication skills to explain what the valuations meant not only to the Director but also to the County Administrator and County Commission. Based on the review of several different scenarios provided by the actuary the County Administrator and the Director of Financial Services came up with what they believed to be a successful solution.

The County decided to change its retiree health insurance benefit mechanism from paying a percentage of the health care premium to paying a defined monthly contribution. For FY 2008, contributions will start at \$400 and increase up to \$1,500 per month per retiree, depending on Medicare eligibility and dependent coverage. The contribution will just about pay the entire premium for the least expensive health care option (Kaiser), meaning that a retiree choosing this option should have minimal increases in health care costs for the next few years. However, the County will still offer retirees access to the full array of health care plans it offers active employees, with any difference between the premium for these more expensive plans and the County contribution being paid by the retiree. The County estimates retirees will pay about 25 percent of their insurance premiums. Furthermore, the County's new OPEB funding policy does not promise contribution increases, such as COLAs, although the Commission can choose to increase them when approving the budget. By taking the steps described above, the County cut its OPEB ARC, and AAL, by more than half, saving hundreds of millions of dollars over time.

During the same time period that it was working on GASB 45, the County also began implementation of its own locally-governed pension plan rather than remaining as part of an agent-multiple employer plan. The new Gwinnett pension plan has its own seven-member management board, composed of county management (e.g., Finance and HR directors), two employee representatives, and two citizens appointed by the County Commission and the

County Administrator, respectively. The pension board has hired its own financial managers to direct trust assets.

The County planned all along for the OPEB trust to dovetail with the new pension trust. Though the funds are separate, the retirement board will manage both trusts on behalf of the County. The County decided to create an irrevocable OPEB trust because of the benefits previously described in this report. However, before the County could do this, it needed legal authority. So, Gwinnett crafted state legislation that enabled local governments to establish OPEB trust funds. The county and municipal associations supported the bill, and the legislation was signed into law in 2007. By June, the County had completed creating the trust.

To fund the OPEB trust, revenues will come from retiree premiums, county contributions for retirees, a small portion of active-employee health payments (because of the accrued liability of active employees), and interest on investments. Like the pension trust, the County Commission has transferred management of the trust to the pension board through a trust agreement. To kick-start interest earnings and fund its ARC, the County began setting aside revenues in FY 2006 (\$10 million in reserve) and will have completely funded the ARC in FY 2007.

Gwinnett was able to move quickly in addressing necessary funding changes for several reasons. First, Georgia is a right-to-work state, and the County does not have collective bargaining agreements with unions. Second, the County never explicitly promised health benefits to retirees (i.e., no guarantee is in writing). Third, the County did not substantially change its health care plans in order to reduce or eliminate benefits. The County has changed only the insurance funding mechanism and has not altered access to health care; therefore, the County's attorney believes the government can win any possible legal challenges to its new benefit funding policy.

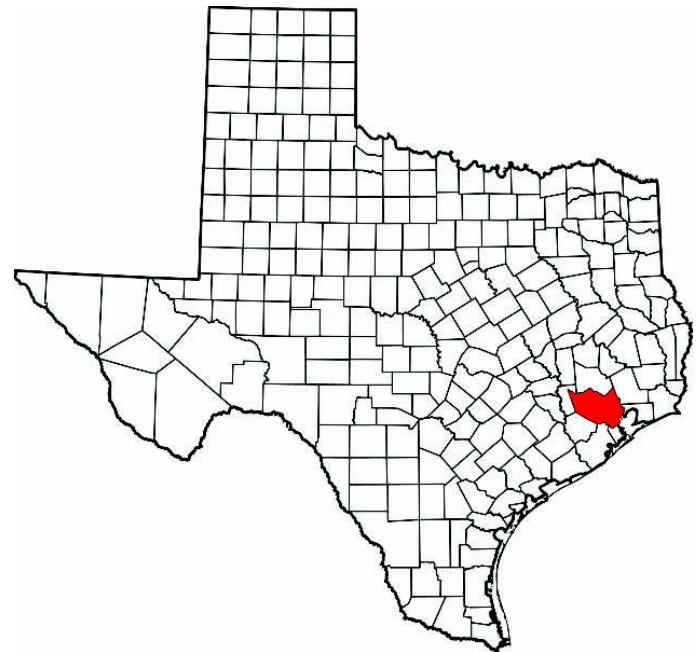
Gwinnett County's hard work should pay off in terms of approval from credit-rating agencies. The County has earned AAA bond ratings and wants to keep them. Senior staff have regularly communicated with the credit-rating companies, and the latter are pleased with the County's progress in managing its liabilities, funding the ARC, and establishing a trust.

The last piece of implementation will occur this October during open enrollment for health benefits. To help explain the new funding mechanism, the County will need a massive communication effort. One of its key challenges will be in minimizing misperceptions of retirees. Fortunately, the Commissioners are all sufficiently well-versed on GASB 45 and the County's OPEB liability to respond to constituent concerns.

HARRIS COUNTY, TEXAS

Though the County has completed the major components of its new OPEB – GASB 45 implementation plan, staff do not see their work as finished. Rather, they believe benefits should be continually managed. The Risk Management Division will continue to review and revise as necessary the health plans it offers as well as its health fund administration. The County is also reviewing its implicit-rate subsidy and may consider adjustments to its premium structure as well.

Senior staff members generally believe that GASB 45 has helped the County to think about health plans and benefits more realistically. With the OPEB liability information provided by the actuarial valuations, officials better understand what the government can afford to pay today as well as in the future. Gwinnett County leadership feel they are prepared both to pay contributions for retirees and to stay within budget limits because of restructuring the County's OPEB financing mechanism. In sum, staff are pleased with the results of their hard work. In terms of overall process and the ensuing decisions (i.e., set monthly contribution, creating a trust and moving its management to an independent board, establishing funding policy), they would do it all again.



AAL 2007:	\$834 million
ARC 2007:	\$90 million
Discount rate:	7.0%
Population 2006:	3,886,207
FTEs FY 06:	15,840
General Fund FY 06 ³⁰ :	\$1,093,909,693

Harris County has been working on GASB 45 for years, and though a new state law that provides the option to local government entities not to include OPEB liabilities on its balance sheet in FY 2008, that has not stopped the County from addressing retiree health-care costs and thinking about the future.

Retiree Health Plan Snapshot

- County generally pays 100% of premium for retirees and 50% premium for dependents for a “Base” medical plan. Retirees pay an extra 10% of the premium for the “Plus Plan,” which provides a higher level of benefits
- Benefit qualification depends on combination of years of service and age. Qualifications differ depending on employee status: new or current employee; when qualifying for retirement; (read below).
- Insurance is secondary coverage when retiree qualifies for Medicare.

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- Medical plans include prescription coverage. Dental and vision coverage are also provided and paid 100% by the County for retirees and 50% for their dependents.
- County is self-insured for 2 PPO medical plans and purchases insurance for group dental and vision.

Health Plan Details and Implementation

For the last few years, Harris County has been involved in preparing to account for GASB 45 liabilities, with staff from the Management Services Department (includes Budget Management and Human Resources & Risk Management) and the Auditor's Office taking on the most responsibilities. While keeping the Auditor's Office abreast of changes in liabilities, the Human Resources & Risk Management Office took the lead in adjusting the rules and eligibility for retiree health benefit contributions and in contracting for actuarial reports. Both groups worked to present the impact of GASB 45 to the County Commissioners' Court. The Auditor wrote a letter to the Court explaining pros and cons of complying with the new accounting statement, and a management team from Human Resources & Risk Management and Budget met with the Commissioners' staff to educate them about GASB, health care costs, and implications of continuing PAYGO for retiree health benefits.

The Human Resources & Risk Management Department has been preparing for GASB 45 for several years by completing actuarial valuations on its OPEBs and by making adjustments to its health plans and proposing changes to the County's contribution policies. These adjustments were undertaken not only for GASB 45, but also as an effort to control medical-cost increases, which have been in the double digits since 2000, and to encourage employee longevity with the County. The most significant health plan adjustment occurred in 2006 (effective in 2007) and primarily impacts incoming employees. The County determines eligibility for OPEBs based on years of service plus age. Employees retiring before 2011 are grandfathered under the existing requirement to reach a combined age-plus-years-of-service score of "75." Employees in this group can receive partial benefits with fewer than 10 years of service. Current employees retiring after 2011 must have at least 10 years of service and either (a) retire at age 65 or (b) if retiring before reaching age 65, then must have a combined service-age score of "80." New employees have a slightly more stringent requirement. To receive any contributions toward their benefits, new employees must have a minimum of 20 years of service and a combined age-years-of-service score of "80," or they must have reached age 65 with 15 years of service (again, a combined score of "80").

By incrementally implementing changes and by including a "grandfather provision," the County limited resistance to the benefit adjustments from employees. By making the "Rule of 80" apply

to employees who plan to work for several more years, retirement plans were not disrupted for older workers and current retirees are unaffected. Furthermore, the new "Rule of 80" only results in an extra 2.5 years of work for most employees. The most significant change involved extending the required years of service, and this applies only to new employees, who will be accepting the policy with their employment. To prevent their confusion and anxiety, the County educated and counseled employees about the benefit modifications. Finally, the County is not bound by labor contracts with its unions in managing salaries or benefits, further reducing the potential for conflict in implementing necessary changes.

Though it amended its health benefit structure, the County maintains its goal of providing a generous retiree health benefit program while managing this cost in a prudent manner. The County views OPEBs as part of its total compensation package: pension and OPEBs, and the former's limits are compensated by the latter. More specifically, Harris County retirees do not receive cost-of-living adjustments for their pensions; thus minimizing health care costs becomes very important to them. Retirees and employees have historically shown preferences for a generous health benefit over an increased pension when given the opportunity to choose.

To have the final OPEB liability ready by the end of the fiscal year, February 28, 2008, the County will conduct one more actuarial valuation this fall. However, based on the scenario data presented by the actuary, Harris County expects the changes effective in 2007 to have decreased the AAL by \$125 million and the ARC by \$33 million. This new AAL and ARC are presented at the beginning of the profile. Harris County achieves such large dollar savings by 1) encouraging employees to work until age 65 when the health plan becomes supplemental to Medicare and 2) simply being such a large organization. The health plan has approximately 30,000 members (employees, dependents, retirees), and extending the careers of employees even 2.5 years can make a big fiscal impact.

In terms of funding the ARC and managing assets, the County is evaluating its options. The County decided to continue funding its OPEBs with PAYGO levels for FY 2008 and is in the process of reviewing means for advance funding the ARC. At this point in time, the County has no plans to establish an irrevocable trust, but Human Resources & Risk Management is considering using the County's existing health-insurance health trust for asset management. The County has concerns about creating an irrevocable trust, concerns which are echoed by Human Resource and Finance Directors from some other counties. These concerns involve access to fund assets should the health benefit become unnecessary, for example, because of the creation of a national health care plan. Furthermore, the County is wary of the trust being construed as an unlimited promise of benefits to future retirees. The County,

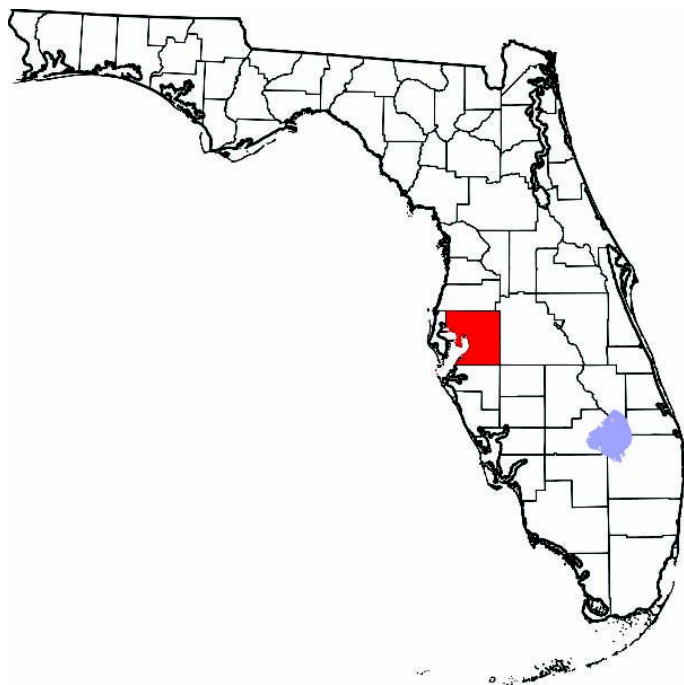
through the Commissioners' Court, has the right to change OPEBs at any time and does not want to jeopardize that standing.

In the short term, the most critical financial decision facing the County is whether to implement GASB 45 at all. In July 2007, the State of Texas enacted a law that limits the requirements of the state and its political subdivisions from accounting for OPEBs on other than a PAYGO basis.³¹ However, due to some ambiguity in the law's applicability for local governments, the County Auditor will seek legal guidance from the County Attorney on whether Harris County has the right to fully include OPEB liabilities on its balance sheet. In Texas, the County Auditor is appointed by the majority of State District Judges for that county, making the position independent of the County Judge and Commissioners' Court. The Auditor has decided that at a minimum, the County will disclose the OPEB liability in footnotes; however, she is leaning toward implementing GASB 45. If the OPEB liability is not formally booked on the County's balance sheet, the government will face an audit exception for non-compliance with generally accepted accounting standards in its annual audit (CAFR). Though the fiscal year ends February 28, the Auditor's Office will be ready to disclose the County's OPEB liability under GASB 45 if required.

Though the County Auditor has final authority in deciding whether to comply with GASB 45, the County Commissioners' Court decides the policy issues that ultimately result in the OPEB liability (i.e., retiree health benefits, funding, etc.). Staff believe that acknowledging Harris County's OPEB liability will be necessary, even if informally, when obtaining a credit rating and issuing bonds in the future. The Harris County case illustrates the underlying issues with GASB 45 compliance (managing retiree health care liabilities, funding the ARC, etc.) are likely to be the real areas of interest for financial lenders.

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 31 H.B. 2365. State of Texas 80th Legislative Session. Chapter 2264, Subchapter B, Sec.2264.051 "The system of accounting for and reporting the financial activities of this state and its political subdivisions: (1) must be consistent with the state financial laws; (2) may not misrepresent the nature, scope, or duration of the financial activities of the state political subdivision; and (3) may follow the statutory standards in this chapter when other accounting bases conflict with state law.

HILLSBOROUGH COUNTY, FLORIDA



AAL 9/30/07:	\$99,724,110
ARC 9/30/07:	\$8,154,863
Discount rate:	4.5%
Population 2006:	1,157,738
FTEs FY 06:	10,429
General Fund FY 06 ³² :	\$776,166,000

By distributing its ARC payment across all funds and revenue sources, Hillsborough County developed a straightforward yet creative way to fully fund its ARC in the midst of severe budget constraints.

Retiree Health Plan Snapshot

- Retirees receive health care compensation from both the State of Florida and Hillsborough County. County must contribute to retiree health-care benefit provided via the state.
- County's direct contribution is based on years of service with a maximum of \$150 per month. Benefit stops at age 65, when retiree is eligible for Medicare.
- Retirees have access to county health plan at same premium rate as active employees (implicit liability). Health plan includes prescriptions.
- Retirees pay full premium for dental and vision, but can access County's group plan.

- Vesting of health benefits after 6 years of service.
- Retirees can begin receiving benefit when reach normal retirement age: 62 for general employees and 55 for fire and law enforcement personnel.
- County offers 2 self-insured plans.

Health Plan Details and Implementation

To provide retiree health benefits, Hillsborough County is legally bound by requirements under Florida law (Florida Statute 112.0801). First, counties must offer retirees access to the same health benefit plans at the same rate as active employees; however, Florida does not require counties to subsidize the premium directly. Because of this law, Hillsborough does face an implicit rate liability under GASB 45.

From a second mandate, the State of Florida Retirement System charges each local government a fee based on a percent of its payroll (1.11%), and the State then provides a subsidy (up to \$150 per month) to retirees. Because the benefit is through the State and the county pays this liability annually, Hillsborough does not incur an actuarial liability under GASB 45 from it.

In addition to the State benefit, Hillsborough County chooses to offer retirees an additional subsidy. Employees receive up to \$5 per month for each year of service with a maximum contribution of \$150 per month. Eligibility begins when a qualified vested employee retires; (standard employees are eligible at 62); the benefit ends when the retiree reaches age 65, i.e., qualifies for Medicare. However, after age 65, the employee continues to receive the State's monthly benefit. As an example, an employee who retires at age 62 with 30 years of experience would receive \$150 per month from Hillsborough and \$150 per month from the State until age 65. At that point, the former employee would receive \$150 from the State only.

Having undertaken an actuarial valuation for a proposed retiree health-care subsidy increase a few years earlier, the County's Risk Management Director was not too surprised by the County's OPEB liability under GASB 45. Relatively early in the process, the County decided to keep the health-insurance subsidy intact for now. Furthermore, the County did not want to change the actual health insurance plans, since that action would impact both retirees and active employees. Leaving the expenditure side of their OPEB liability unchanged, the County wanted to find a way to raise revenue and fund its ARC. Funding the ARC is important because neither the Commission nor senior management want to jeopardize the County's AAA bond rating.

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Rather than raise taxes or assign all the liability to the General Fund, the County decided to cost-allocate the ARC across all de-

partments. The County determined that the additional revenue needed to fund the ARC equaled \$50 per permanent position and added that expenditure across all the funds. Therefore, proprietary funds with permanent positions or departments that collected fees would share in the cost, which is reasonable since their employees (and former employees) are a part of the OPEB liability. The departmental assessment raised \$6 million which, when added to the \$2.1 million already being paid for OPEBs under PAYGO, fully funded the County's \$8.1 million ARC.

The County has decided to create a trust in which to deposit OPEB contributions, but not an irrevocable one because the County wants the financial flexibility to access reserves in case of a major emergency, like a hurricane. As an internal service fund, the new trust will be managed by the County Budget Office. Since County assets are invested conservatively, the staff asked the actuary to estimate the AAL with a low 4.5% discount rate. In sum, the Hillsborough is accepting fiscally conservative valuations in exchange for potential access to trust assets.

GASB 45 implementation involved multiple departments with a team approach. The Risk Management Division (in Human Resources) took the lead in implementation because of the Director's knowledge about the health benefit program. Throughout the process, however, the Risk Management Director worked closely with the County Administrator, Budget Director and Budget Office staff to develop the funding mechanism. The County management believes the process has been successful.

Staff believe that their communication efforts have been fairly successful overall. Explaining GASB 45 and the actuarial report to the County Commission went well. First, the County Administration approached the topic in a straightforward manner, and the Commission was able to easily understand the differences between the County's implicit rate and direct subsidies for OPEBs. It helped that the Administrator was able to relate the impact of GASB to previously proposed changes in sick leave policies, which the Commissioners had worked through earlier. There has been little interest in GASB 45 on the part of retirees and the public generally, perhaps because of the proposed legislative property tax changes, the County-maintained health care subsidy, and the decision not to raise taxes to fund the ARC. Communication will continue to be an important component of GASB 45 implementation and OPEB management generally for Hillsborough since their retirees are politically active and stay abreast of government affairs.

The Commission's and senior management's commitment to fully fund the ARC is particularly admirable since the County is facing severe budget constraints. The issue for the County as with all local governments in Florida concerns property tax reductions proposed

by the State Legislature. Depending upon action by Legislature this fall, the County may need to reexamine its ability to continue to fund the County subsidy, calling again on the creativity, teamwork, and communication skills of Hillsborough County.

MECKLENBURG COUNTY, NORTH CAROLINA



AAL 7/1/07:	\$141,825,529
ARC 7/1/07:	\$14,696,388
Discount rate:	7.5%
Population 2006:	827,445
FTEs FY 06:	4,282
General Fund FY 06 ³³ :	\$1,208,843,249

For Mecklenburg County, GASB 45 has been a priority issue. In fact, GASB 45 / OPEB funding was one of the five major policy decisions for the FY 2008 Budget. Having addressed the issues, the County is poised to meet its fiscal obligations over the next several years.

Retiree Health Plan Snapshot

- With 10 – 20 years of county and/or military service, County pays 50% of employees' individual insurance premiums (for standard plan). Employees pay premium for spouses.
- With 20 or more years of county and/or military service, County pays 100% of individual premium (for standard plan). Employee pays premium for spouse.
- Health plan includes prescriptions, some vision coverage.
- Retirees pay entire dental insurance premium (implicit liability).
- Employees vested after 10 years of service; must accept insurance benefit at time of retirement.
- When retirees become eligible for Medicare, County insurance becomes supplemental. Retirees can choose non-County supplemental insurance, and County will pay premium up to value of its own plan.
- County offers 2 self-insured plans (PPO standard and enhanced).

Implementation

When evaluating its OPEB liabilities under GASB 45, the County chose not to alter its retiree benefit program. The County came to this decision free of the common political or labor pressures

governments often face, since the County's retirees tend to be politically inactive and the County does not negotiate labor contracts with unions. Rather, the decision is based on the County's belief that OPEBs are important for recruiting and retaining top-notch employees in their economically vibrant community. That said, the County does regularly evaluate its programs, and, when necessary, will revise its health benefit program to keep cost increases in check.

As stated above, deciding on levels of funding for GASB 45 OPEB liabilities was the key issue for the County's FY 2008 budget (FY begin July). The Commission considered two primary questions:

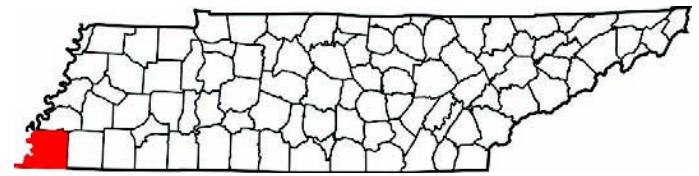
- 1) Whether to fully fund the ARC or phase in funding over two or three years. Full funding meant increasing OPEB expenditures by an additional \$10 million (PAYGO equaled \$4.7 million), while phasing in funding resulted in lost investment income and unfunded liabilities on the balance sheet.
- 2) Whether to fund the County's two component units: the Library and Medic services. Though the assets and liabilities of these services are included as part of the County's financial statement, the two units have funding sources that are separate from those of the general county government. These two units had a combined AAL of \$28.5 million and a combined ARC of \$2.2 million.

To help with these budget decisions, the Finance Director presented information on all the components of GASB 45, the County's OPEB actuarial valuation, and various funding scenarios for the ARC. Because the County had never previously faced a similar issue, the Commissioners were unfamiliar with GASB 45's accounting concepts and terminology. In some respects, the Finance Director found presenting accounting material to non-accountants one of the more difficult aspects of GASB implementation. Fortunately, the Commissioners wanted to learn about the issues, were not shy about asking questions, and as a result, were able to make fully educated decisions. Mecklenburg provides a great example for other Commissioners and their staff who may be intimidated by the technicalities and jargon of GASB 45.

After a thorough vetting of ideas, the Commission decided to fully fund the ARC for the County government using general-purpose tax dollars. State law prohibits counties from issuing OPEB bonds, eliminating this funding option for the County. By building the ARC into general operating budget rather than relying one-time revenues, the County has essentially "bitten the bullet" and will not have to face such a significant jump in OPEB spending again (assuming no major changes in benefit levels). However, the County did not institute a fiscal policy to fully fund the ARC, so a future County Commission could choose a different direction for OPEB funding.

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General Fund Revenues

SHELBY COUNTY, TENNESSEE



The County also decided to have the Library and Medic services retain responsibility for their own OPEB liabilities.

A major incentive for fully funding the ARC was to maintain the County's AAA bond rating. However, based on the pronouncements that the credit-rating companies have published, the Finance Director felt comfortable that the County's rating would not be jeopardized either with full funding or with a brief phase-in period for the ARC.

In addition to its budgetary impacts, the Finance Director is also looking at how GASB 45 affects accounting processes and vice versa. Knowing the actual liabilities (i.e., claims) of plan members is an important component of managing health care costs. Currently, the County does not differentiate between the claims of active employees and of retirees. In order to ease data collection for their next actuarial valuation, the Finance Director is establishing a chart of accounts for their health insurance fund that will distinguish claims by participant group. This knowledge may be helpful for managing both health-care benefits and the County insurance fund.

Finally, the County plans to develop an OPEB trust, but is waiting to learn whether proposed State legislation will provide an additional trust option. Other recent legislation has authorized the County and a handful of other local governments to invest assets in equities – a necessity if the County is to achieve any substantial return on investments. Previously, no local government had authority to invest money in equities, it being deemed unnecessary since local government employees participate in the State's retirement system. The County hopes to have made final decisions about its trust by the printing of this report. After creation of the trust, the major policy decisions for GASB 45 will have been addressed.

AAL 6/30/06:	\$267,362,000
ARC 6/30/06:	\$28,222,000
Discount rate:	5.25%
Population 2006:	911,438
FTEs FY 06:	6,277
General Fund FY 06 ³⁴ :	\$332,908,288

Shelby County learned the importance of effective communication with stakeholders and found that a trusted elected official can make world of difference in communicating OPEB changes to retirees and employees.

Retiree Health Plan Snapshot

- *Retirees and current employees under age 65:* County pays 70% of insurance premium
- *Retirees under age 65:* County pays 70% of insurance premium for retirees with 20 years service; the County percentage decreases with fewer years of service.
- *Retirees over age 65:* Moved to insured plan which is supplemental to Medicare. County pays 70% of insurance premium for retirees with 20 years service; the County percentage decreases with fewer years of service.
- *Current employees:* Must have 7.5 years of service and retire from County to receive health benefits.
- *Employees hired in 2007 or after:* County no longer provides insurance subsidy if retire before age 65, but is continuing 50% premium subsidy for Medicare-eligible employees.
- *Employees hired in 2007 or after:* Requires minimum of 15 years of service to receive insurance benefit.
- Premium rates are based on employment status: active employee; retirees under age 65; and retirees over age 65.
- Health insurance includes prescription but no dental or vision.
- Self-funded plan for current employees and retirees under age 65.

Implementation

Shelby County began implementation of GASB 45 over two years ago with its first actuarial valuation. For that valuation, the County

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needed to use a 3% discount rate because it lacked authority to establish an irrevocable OPEB trust. The valuation showed the County as having a \$600 million unfunded long-term liability and a \$60 million ARC, which was \$50 million higher than its current PAYGO amount. The County quickly realized that raising \$50 million in revenue was not going to be embraced in the current political climate, which tends toward shrinking the size of government and steering clear of tax increases.

The County was fortunate to have a commissioner who focused on OPEB liabilities in the late 1990's. Appreciating the similarities to FASB's³⁵ OPEB accounting statement for the private sector, the commissioner understood that GASB would probably require the same fiscal commitment for local governments. This commissioner served as a leader, working to pass resolutions in 2002 that tightened the County's retiree health benefits and to educate fellow commissioners on the possible impacts of sustaining a long-term OPEB liability.

In September 2006, the County Commission, which included 8 new commissioners for a board of 13, held a retreat that included a discussion of GASB 45. At a subsequent meeting, the Commission decided to look at alternatives for lowering OPEB liabilities. Staff took that directive and began brainstorming alternatives with the actuary, creating several scenarios for the Commission to evaluate. Important considerations for any proposed change were 1) not requiring a tax increase to fund the ARC and 2) not dramatically changing health benefits for current retirees and employees. An additional challenge came with the realization that if the County decreased retiree health benefits too much, employees might be encouraged to continue working, which ran counter to the goal of creating a smaller government through attrition. The benefit changes that the Commission ultimately accepted resulted in decreasing the County's ARC to \$28.2 million, more than half the original estimate (see Snapshot above). Because the biggest modifications to OPEBs will be for new employees, the County's liability will decrease over time.

As for funding the FY 2008 ARC, the County is "middle of the road" approach. The FY 2008 ARC will be fully met with a combination of one-time (\$12 million) and current (\$16 million) revenues. The current revenues are generated through an assessment to each department equaling 6.5% of active employee salaries. The one-time revenues come from drawing down the health insurance trust fund balance. The Finance Director had built up the health fund's balance over the last few years in anticipation of GASB 45 by using that same departmental assessment; however, the 6.5%

of salaries was higher than what was needed on a pay-as-you-go basis for the last couple of years. In other words, the County overfunded the health insurance trust fund in order to ease into paying the ARC from the County's operations budget (i.e., General Fund). With the next valuation in two years, the County can better gauge how the health benefit changes have impacted its long-term liabilities. At that point, the County will determine whether or not it needs to fund more of its ARC.

The next item on the County's GASB 45 implementation agenda is creating an OPEB trust. Now that the County has authority from the State, the Finance Director is planning the trust and hopes to have it established by the end of the calendar year. Though many governments are using an OPEB trust discount rate of 7.5%, Shelby is choosing a more conservative figure of 5.25%. The County is also likely to have its pension board, which consists of a combination of elected officials, employees, and retirees, manage the OPEB trust because of the board's investment experience and readiness.

One OPEB issue that the County did not need to address was implicit rate liabilities. The County had already established insurance premium rates based on the claim costs of plan members well before GASB 45. The County had established three tiers of payments: active employees, retired pre-Medicare, and retired Medicare. Active employees and retirees on Medicare are, on average, the least expensive because the former are the healthiest group and the latter use the County insurance as a supplement to Medicare. Concomitantly, these groups had less expensive premiums than pre-Medicare retirees. There is an interesting equity component to this system as well. A younger, more recent retiree is generally in better financial condition than an older retiree and therefore is in a better position to pay the higher premiums. By breaking out the retirees into two groups for premium differentials, the County has also addressed an equity concern.

Throughout the GASB 45 implementation process, County staff have been talking with credit-rating agencies as well. Understanding the position of the rating companies was important because the County has achieved an AA/AA+ rating and would like to maintain it. The feedback suggests that the rating agencies are pleased with County's implementation progress, particularly its efforts to address underlying OPEB liabilities.

Though Shelby County started the GASB 45 process early, staff also learned that a critical component of effective implementation is communication. Staff were successful in educating the Commission first about OPEBs and then about the relationship of OPEBs to GASB 45 and liabilities. Staff kept the discussion focused on the big picture and the ARC, because the latter is more real and generally more easily understood than the relatively abstract AAL.

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BERNALILLO COUNTY, NEW MEXICO

Like many of the counties in this study, Shelby held a public Commission hearing when the proposed health benefit changes were to be approved. Unfortunately, staff and elected officials were unaware of the level of misinformation that had circulated among retirees and active employees about the proposed benefit changes. Many retirees and employees attended the public hearing in an effort to stop the process. As a result, Finance Director developed more health-care benefit alternatives and created a new set of fiscal documents.

Not only did the Finance Director develop new retiree health benefit alternatives, he also placed the financial documents on the County's website. In addition, the Mayor wrote a letter to all employees and retirees explaining the proposed changes to health benefits. In other words, he communicated facts before misperceptions could create confusion and stress. The County widely advertised the next public hearing and even provided special parking for retirees to encourage attendance. Again, attendance at the meeting was high. Yet even with the County's efforts, some retirees still misunderstood the reasons for the benefit changes and the impact the changes would have on them. However -- and most important -- opposition to the County's plans faded once retirees and employees heard the facts.

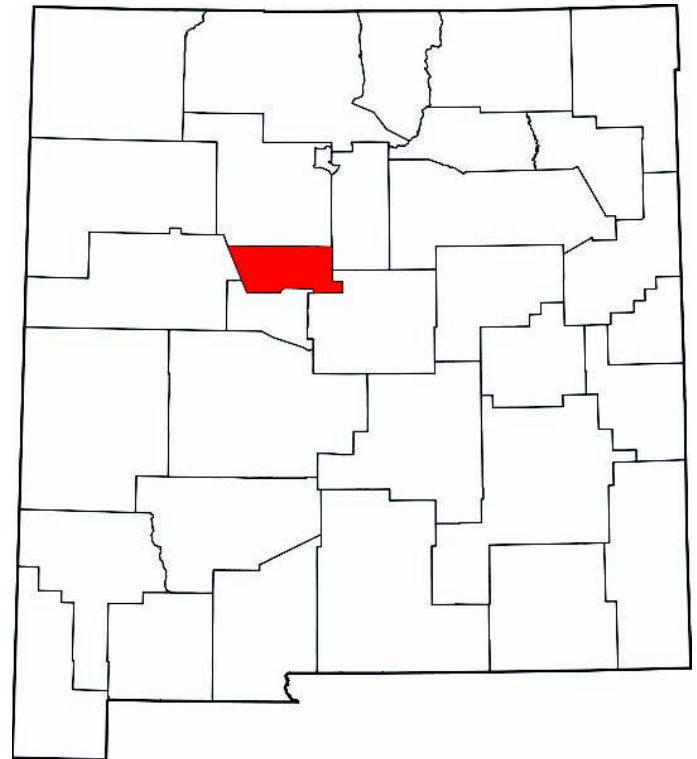
A key factor in having the retirees "listen" was the speaker. The Mayor spoke on behalf of the County, explaining the health benefit changes and the reasons for them. Having the Mayor present the information was particularly important because he is very well respected throughout the community. Furthermore, employees know that he sincerely supports them, and therefore they trusted his assertion that health benefits were not going away.

Shelby County's experience demonstrates the importance of several key issues in GASB 45 implementation:

Starting early to ensure sufficient time for learning about the statement, evaluating health benefit and funding alternatives, and decision-making.

Communicating with all stakeholders to avoid miscommunication and possible frustration and fear from retirees and employees.

Having a well-respected leader discuss proposed changes. His or her promise will have far more weight than that of an outside actuary or unknown staff person.



AAL:	Not Applicable / Unknown
ARC:	Not Applicable / Unknown
Discount rate:	None
Population 2006:	615,099
FTEs FY 06:	1,608
General Fund FY 06 ³⁶ :	\$185,515,087

With the New Mexico Retiree Health Care Authority (NMRHCA) providing health-care benefits to County retirees, Bernalillo is not currently anticipating facing OPEB liabilities under GASB 45. However, this situation is dependent upon whether the NMRHCA and the State Auditors believe that the NMRHCA should retain the liabilities or that these liabilities should fall back to member governments. Because the County is assuming that OPEB liabilities rest with the Authority, the County is taking a "wait and see" approach to the new accounting rule.

This profile first describes the NMRHCA and then discusses Bernalillo's position as it relates to the Authority and GASB 43.

Retiree Health Plan Snapshot

- Because County is a member of the NMRHCA, County employees receive their OPEBs from the State.

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- To fund the benefits, active employees pay 0.65% of their salary and the County contributes 1.3% of each employee's salary to the NMRHCA.
- Retirees receive a defined benefit in exchange for a defined retiree contribution, which is applied to plan costs. Liability for cost increases is shared by the retirees and NMRHCA
- After becoming Medicare-eligible, retirees have a choice of supplemental benefits or a fully insured Medicare Advantage Program.
- Benefits under NMRHCA include medical insurance, prescriptions, vision, dental, and life insurance.
- Employees of member employers are eligible for coverage with NMRHCA after 5 years. A retiree's subsidy is based upon years of service, with full benefits received after 20 years. The individual must be eligible to receive pension benefits from PERA or ERB to commence benefits under NMRHCA.

In 1990, the State of New Mexico created the NMRHCA to offer high quality retiree health care to public employees, and Bernalillo County was one of its initial members. Each member's retirees sign up for benefits with the Authority, meaning that all promises and agreements are between the retiree and the Authority and with not the retiree's former employer.

This arrangement has led some to believe that all OPEB liabilities lie with the NMRCHA. NMRCHA's external auditor has also valued the health plans as being a liability under GASB 43 (see below) because the structure of the arrangement between the NMRHCA and member governments is for the most part "equivalent" to an irrevocable trust.³⁷ GASB 43 is an accounting statement similar to GASB 45 in technical requirements, but it applies to "OPEB trust funds included in the financial reports of plan sponsors or employers or the public employee retirement systems, or other third parties that administer them."³⁸ If the State Auditor and the NMRHCA determine the organization falls under GASB 43, then all the OPEB liabilities from member governments will rest with it. GASB 43 has highlighted the Authority's very significant UAAL³⁹ (unfunded AAL), which has accumulated from high levels of retiree benefits relative to member contributions. An issue that remains outstanding for Bernalillo as well as all non-state NMRHCA members is whether the State will fully fund the UAAL

and ARC under GASB 43. The situation of the NMRHCA is as follows:

NMRHCA	
UAAL 6/30/06:	\$4,109,642,299
ARC 6/30/06:	\$383,243,843
Discount rate:	5%
Current retirees 6/30/06:	24,815
Current active members:	115,477 (future retirees)

The NMRCHA is an independent, self-funded state authority. Membership in the Authority is composed of state and local governments, including the State of New Mexico, public universities, city and county governments, local public authorities, and school districts. Membership for universities and local governments is voluntary. When the Authority was initiated, members could join without advance-funding the estimated actuarial liability for their employees; however, that rule changed in 1998 and again in 2007. Since then, governmental entities must "buy into" the authority based on the actuarial accrued liabilities of their current and future retirees.

The Authority runs much like any other governmental self-funded health insurance program. Retirees sign up for benefits, choosing from several insurance-plan options with premiums varying by the level of benefits offered. The program is administered by a third party. In terms of funding, revenues come from premium contributions of active retirees, employees, and member governments, and from investment earnings. The system runs much like Social Security in that active employees "contribute to their future retirement," but in practice current revenues are used to pay claims for current retirees.

As can be seen from the data given above, the biggest issue facing the NMRCHA is its UAAL and ARC. In fact, the current estimated solvency for the fund is nine years, assuming no changes are made to benefits or revenues. The reasons for the high UAAL are manifold: double-digit inflation for health care services; an 8% increase in the number of retirees joining the Authority in 2007, with that rate of growth to continue for the next 5 years; the lack of a minimum retirement age, resulting in many retirees beginning their participation in their late 40s and early 50s; and the lack of initially mandated advance-funding by participating governments.

The NMRHCA's current actuary believes that the organization's entire liability under GASB 43 lies with the State of New Mexico, since the NMRCHA is a state agency and retirees sign agreements for health insurance with the Authority and not with their former employers. In pragmatic terms, even though the Authority

37 Taken from email correspondence from the auditor of NMRHCA, Gary Peterson, Segal Company on September 13, 2007.

38 Governmental Accounting Standards Board. 2004. *Summary of Statement No. 43: Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. Washington, DC. pg. 1. www.gasb.org

39 The UAAL is that portion of the AAL which is unfunded, similarly to an unfunded pension liability. If no revenues have been set aside to fund the AAL then the UAAL and AAL will be the same.

is independent, its liabilities are “rolled up” with all other state organizations as part of the State’s audit (i.e., in combined balance sheet). Interested stakeholders are not sure how this liability will affect the State’s bond rating. In contrast, county governments are not required to show any liability on their balance sheets but might need a footnote in their financial statements regarding this benefit. However, this interpretation has not been deemed final by all interested stakeholders.

Though the New Mexico legislature debated OPEB liabilities in 2007 session, no definitive decisions were made regarding whether or how to fund the ARC. However, the State did pass a law (HB 728/Chapter 168) creating a study committee to examine the long-term health of the NMRCHA and options for improving the actuarial soundness of the fund.⁴⁰ The State is also waiting to decide whether to allow the NMRCHA to create an OPEB irrevocable trust, which could lessen its liability by \$1.5 billion simply due to higher interest earnings on investments.

Ultimately, the State, either through legislation or changes initiated by the NMRCHA Board, will have to address the Authority’s UAAL and ARC, and they are limited to four general options:

- reducing benefits to current or future retirees;
- raising the revenue contribution from the State General Fund;
- negotiating more favorable health care delivery contracts;
- increasing the level of contributions from retirees, active employees and/or member governments.

Option 1 may be difficult to achieve because of the liberal culture in New Mexico and the strong political voice of employee unions and retirees. Furthermore, while the State may contribute revenues from the General Fund, it may lack a strong incentive to pay the liabilities associated with other governments’ retirees. Option 3 would probably result in some cost savings, but may not suffice to eliminate the UAAL. When the legislative Study Committee submits its findings at the end of the 2007, resolution to this very important issue may become closer.

Bernalillo County

Senior management feel confident that the Bernalillo County can meet any obligation it may incur from GASB 45. The County has a \$40 million reserve from which it can draw in case of emergencies. This reserve is more than the estimated OPEB liability of approximately \$37 million; (no formal evaluation has been undertaken). The County also has very little long-term debt. Though the County is taking a “wait and see” approach until learning the State Auditor’s final decision on GASB 45 vs. GASB 43 liabilities, the

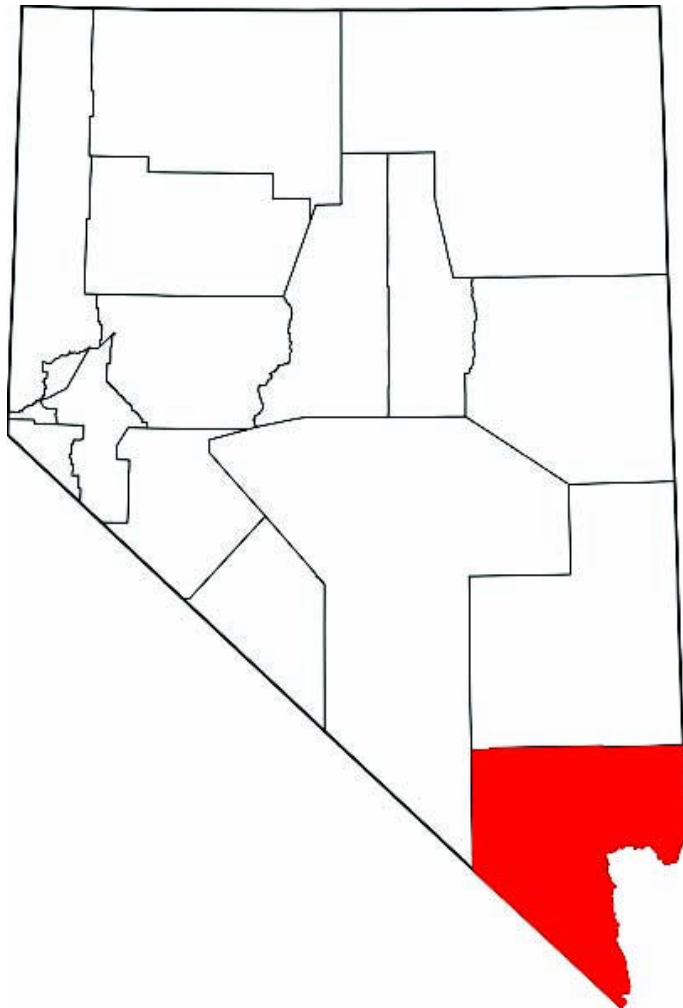
County wants to keep its AA+ bond rating and will take the necessary actions to do so.

Because the possibility of incurring any OPEB liability is still uncertain, staff have not discussed GASB 45 with the County Commission. Nor have the press, employees, and retirees shown much interest in the topic.

The County has a generally positive relationship with the Legislature, and the County Manager is not anticipating any surprises from the 2008 Legislative Session or possible changes to the NM-RHCA that would negatively affect the County. He believes the County and other local governments will be able to work with the Legislature to reach a reasonable funding solution.

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40 Legislative Service Council – Highlights 2007, pg. 9. State of New Mexico.

CLARK COUNTY, NEVADA



AAL 6/30/06:	\$372,300,793
ARC 6/30/06:	\$49,674,823 (General County members only)
Discount rate:	4.0%
Population 2006:	1,777,539
FTEs FY 06:	18,705
General Fund FY 06: ⁴¹	\$929,920,553

Clark County's case demonstrates the impact OPEB state mandates can make on a local government's balance sheet. What would have appeared to be a minor legislative amendment has resulted in millions of dollars of extra OPEB liability for the County, with the final costs still to be determined.

⁴¹ Clark FY 2006 Comprehensive Annual Financial Report. General Fund Revenues only

Retiree Health Plan Snapshot

- State law requires the County to offer retirees access to same health benefits as offered to active employees at the same insurance premium. Retirees pay 100% of premiums (implicit liability) for County health, dental, and vision plans.
- Health plan includes prescriptions.
- From 2003 to 2008, retirees had access to State's health plan. State mandated that County provide premium contributions for retirees that increased based on years of service.
- Employees qualify for access to health plan after 5 years (same as state pension system).
- County offers two self-funded plans (PPO and HMO).

Implementation

Clark County participates in a multi-employer health insurance fund that includes five other public and quasi-public organizations,⁴² though the County is by far the largest member. This group fund has worked well for the last several years. Benefit levels have not significantly changed, and cost increases have been kept down largely due to the market power of their third-party plan administrator.

In terms of GASB 45 compliance, the health fund's actuarial valuation separated out each organization's OPEB liability, and each employer will be solely responsible for meeting its AAL and ARC. In other words, the balance sheet for each organization will include only the OPEB liability associated with its own retirees and employees. The County has received multiple actuarial valuations for its OPEB liability, but due to legislative changes (read below) its total AAL continues to be uncertain. The Comptroller hopes that he will have a better gauge of the County's liabilities and can begin developing ARC funding options after the next valuation, which should be completed by late summer 2007.

Historically, local government employees in Nevada had access only to the State's retirement system (PERS) and not to State retiree health benefits. However in 2003, the Legislature decided to let county government retirees join the state plan, called the Public Employees' Benefits Program (PEBP). For retirees choosing to enroll in PEBP, counties, including Clark, became responsible for paying a monthly premium subsidy which is based on years of county service and continues through the retiree's lifetime. After 5 years of service, a retiree is entitled to a \$90 per month contribution, and after 20 years of service the subsidy equals \$463 per month. Retiree interest in joining PEBP has been strong. By July 2007, just 3 years after the legislation went into effect, 55

⁴² Health fund also includes Regional Transportation Commission, Flood Control, University Medical Center, Water Reclamation District (LVWA), and Las Vegas Convention and Visitors Authority

percent of new Clark County retirees were selecting the PEBP option. The County's upcoming actuarial valuation will include this latest PEBP figure. To put the costs into perspective, the current valuation estimates that, although only 20 percent of the County's retirees have joined PEBP, about one third of the County's AAL is attributable to these retirees. Seeing the financial impact, the Legislature changed the law in 2007, closing access to PEBP by local government retirees effective November 2008. Of course, a concern remains that with so many retirees receiving an explicit subsidy under PEBP, the County may face pressure from other retirees to offer a similar benefit under the County health plan.

In 2007, the State also approved laws regarding OPEB trusts for local governments. Clark County, through its health insurance fund, now has authority to establish an OPEB trust. By establishing a trust and having the additional interest earnings, Clark County should decrease its ARC by more than 50% (\$26 million with an 8% discount rate). The County is now planning for the trust. It is likely that the executive board of the health fund will also serve as the OPEB trustee; however, working through the mechanics of implementation could be somewhat challenging. The County, like all other local governments in Nevada, has the option of joining the State's OPEB trust.

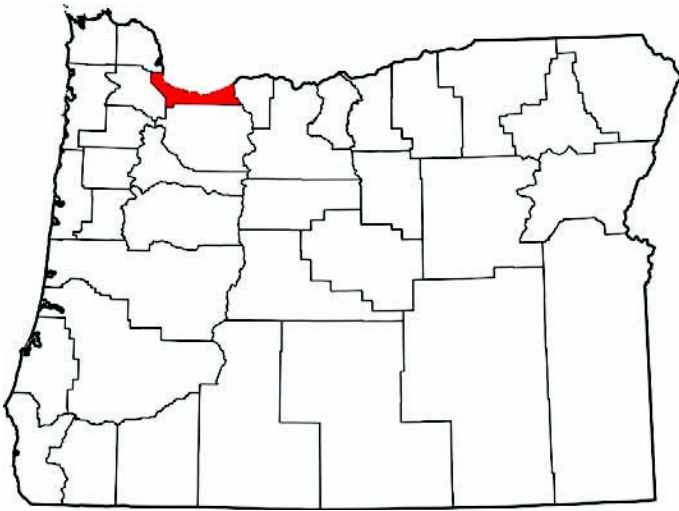
The County plans on partially funding its ARC for FY 2008 using the prior year's revenue surplus as a source of monies for the trust. The County believes that partially funding the ARC shows a commitment to meeting OPEB liabilities, especially when considering such other spending priorities as public welfare and the Public Defender's Office. Furthermore, the Comptroller has spoken with representatives from credit-rating agencies, and they appear to be comfortable with the County's GASB 45 implementation progress. The County currently has AA+/AA1 bond rating, which the Commission and staff recognize as important for borrowing and will work to maintain.

The County is facing one more interesting decision in regard to the firefighters' health trust fund. In Clark, firefighters independently operate their own health insurance fund. Under the current structure, the County has no authority to manage these benefits or set insurance premiums. Rather, these actions are decided by the fund administrator. However, the County still pays for the benefits, and that amount is determined during labor negotiations. For FY 2008, the County contributes \$1,040 per month for each active firefighter. Though this fund is managed without County oversight, under GASB 45 the County will have to include the firefighter's OPEB liabilities on its balance sheet. The firefighter fund administrator did not initially think the trust fund would qualify for GASB 45 and thus had not undertaken an actuarial valuation. Now that the Government Finance Officers Association and the Governmental

Accounting Standards Board have confirmed that the firefighter health trust fund must comply with GASB 45, the Comptroller has been able to begin an actuarial valuation. The results of the valuation should be completed by late fall 2007. Once the AAL and ARC are known and the County has discussed the liabilities with the fund administrator, the County will need to decide whether action is needed to insure the fund's actuarial soundness.

Because of continued changes to the County's OPEB liabilities (i.e., PEBP participation, firefighters' trust), staff have regularly communicated with the County Commission about GASB 45. Generally, these discussions and presentations have gone well. Staff first briefed the Commission on GASB 45 18 months ago after receiving the first actuarial valuation. They have also regularly provided follow-up information through budget hearings. At this point, the Commissioners have fairly strong understanding of the accounting and health insurance policies involved. This communication will continue to be important as the Commission makes future decisions on ARC funding and works with the firefighters' union on their health trust fund.

MULTNOMAH COUNTY, OREGON



AAL 1/1/05:	\$109.9 million
ARC 1/1/07:	\$12.7 million after adjustments
Discount Rate:	3.5%
Population 2006:	681,454
FTEs FY 06:	4,281
General Fund FY 06: ⁴³	\$427,423,000

Multnomah County was one of the first counties in the country to implement GASB 45, having done so for FY 2006. It is an excellent example of the Governmental Accounting Standard Board's point that a county can successfully implement GASB 45 (i.e., adhere to GAAP) without significantly changing its method of operations.

Retiree Health Plan Snapshot

- Defined benefit plan: County pays 50% of retiree's medical plan premium for eligible participants until age 65 or Medicare eligible.
- Health plan includes prescriptions and vision.
- Retirees pay full premium for dental, but can access County's group plan (implicit liability only).
- Vesting of health benefits after 10 years of service. Must reach retirement age of 58 or age 55 with 30 years of service.
- Health plans are supplemental once retirees are eligible for Medicare.
- County offers four self-insured plans and two insured plan (Kaiser).

Implementation

Because its external auditor had recommended making other accounting changes, the County decided to implement GASB 45

early (in the fiscal year ending June 30, 2006). Preparing the financial statement (collecting data, researching options, etc.) required a significant amount of staff time (approximately 100 hours total). Multnomah staff also found that data from the actuarial reports were not always easily transferred into the financial statement footnote disclosures. The experience of this county illustrates the need for staff involved in implementing GASB 45 to meet early with the county's actuary and to allow ample time for collecting the data and implementing the accounting standard.

Beyond the actual valuation, an actuary can be very helpful in the "nuts and bolts" of implementing GASB 45. Multnomah finance staff worked closely with their actuaries in calculating the net OPEB obligation and in preparing the related financial statement footnote disclosure. The actuary had a separate GASB 45 office, ensuring expertise in the area. County finance staff found it very helpful that the actuary was willing to research legal issues related to recording data on the balance sheet in order to implement GASB 45 as well.

Though GASB 45 implementation has been achieved, key financial decisions, like establishing a trust and using advance funding for their AAL, have yet to be decided. Rather than rush a decision, the County has chosen to keep the status quo initially and thoroughly evaluate all options. For FY 2008, the County decided to continue with its "pay as you go" policies for OPEBs (budgeting \$3.2 million). The decision on what method of payment to use (i.e., pay as you go or advance funding) has been one of most difficult aspects of compliance for the County. The County is also debating whether to create a special trust or to use an existing internal service fund. With the latter, the County would benefit from using an existing fund (i.e., not have the administrative costs associated with creating a new trust), and it could use existing balances for higher investment and interest earnings. A further consideration is ensuring that the County's AAA credit rating is maintained, particularly since the County issues general obligation debt and benefits from the lower interest rates that a strong rating provides. County staff have said that an important lesson learned through implementation was the County's need to evaluate its financial position and decide where it wants to be in the future.

Part of the decision on where the County wants to be in the future naturally involves fully appreciating the cost of the County's retiree health benefits. The County's health insurance plans have experienced annual cost increases of 10 and 13 percent in 2006 and 2007, respectively. The main cost drivers are a rich plan design and retirement incentives (i.e., being eligible to retire at age 58), resulting in the County's paying for retirees' insurance benefits for up to 7 years before Medicare benefits and the concomitant cost decreases begin. The high cost of health care can be better understood

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⁴³ Multnomah County 2006 Comprehensive Annual Financial Report, General Fund Revenues only

through the financial ratio of UAAL (uncovered accrued actuarial liability) to covered payroll at 48 percent as of January 1, 2005.

To address health care expenditures, the County's current goal is to level off cost increases rather than make dramatic changes to its current retiree health benefits. The County is working with its 11 labor partners on more modest changes that would reduce both immediate and long-term liabilities.

Unlike the labor contracts of other counties in the study, Multnomah's labor contracts include provisions outlining retiree coverage. These contracts are typically in effect for three years, and each union independently negotiates its pay and benefits package through its labor agreement. Until it dissolved in 2007, the County had successfully used a union-management group to work out health care packages that applied for all employees. The County is unsure how a new labor contract negotiation format will affect active employee and retiree health benefits in the future.

Although the County has "booked" its OPEB liabilities, staff have not seen much interest from retirees, general union membership, the press, or the public at large about GASB 45, though retirees and union groups are politically active. This unconcern may be because the County had previously recorded a liability for "Post retirement medical benefits payable" in the financial statements and upon implementing GASB 45, the cumulative effect was to increase the County's beginning net assets for governmental activities in the Statement of Activities by approximately \$21 million. It is, however, more likely that the absence of interest results from the fact that the County did not change health benefits, raise taxes, or cut programs to lessen liabilities or to fund the ARC. As Multnomah considers its future financial options around OPEBs, GASB 45 may come to be viewed as more than an accounting exercise, and the County may receive greater interest from its politically active retirees and general union employees.

SONOMA COUNTY, CALIFORNIA



AAL 12/31/2004:	\$381,583,171
ARC 12/31/2004:	\$37,161,214
Discount rate:	8%
Population 2006:	466,891
FTEs FY 06:	4,154
General Fund FY 06 ⁴⁴ :	\$464,109,000

The Board of Supervisors and senior management have approached GASB 45 and the concomitant evaluation of their OPEBs with a common goal: establishing a sustainable retiree health-care benefit. Through the goal, the County seeks to recognize the service of former employees, recruit and retain qualified personnel, and ensure resources are available for the government's primary purpose of providing public services.

Retiree Health Plan Snapshot

- County pays premium equal in value to 85% of any insurance premium, and starting in 2008, will be transitioning to 85% of the lowest cost plan.⁴⁵

44 Sonoma FY 2006 Comprehensive Annual Financial Report. General Fund Revenues

45 Applies only to retirees, management, and confidential employees

- Employees hired after 1990 qualify for retiree-only benefit after 10 years of service and for retiree-plus-one-dependent subsidy after 20 years of service.
- Employees must retire from County to receive benefit.
- Plan includes prescriptions.
- County benefit is supplemental to Medicare.
- Retirees pay full premium for dental (implicit liability only).
- Four plans: 2 are self-insured PPO, 1 insured PPO, and 1 insured HMO (Kaiser).

Implementation

In Sonoma, officials have focused most of their attention on the benefit policies that are driving the actuarial liabilities recognized under GASB 45. When thinking about how to manage the liabilities, the County Board of Supervisors relied on two overarching goals:

- 1) Providing personal, professional, and political recognition of health care costs and their importance;
- 2) Protecting health retirement benefits over the long term by making them sustainable. Sustainability entails reaching a benefit-cost level such that the County can provide services for citizens and a fair compensation package to current and former employees who deliver those services.

Of course, a government must first know its liabilities before it can manage them. The County began the process of acquiring its first actuarial valuation in fall 2005, receiving it the following spring. The County decided to hire its pension fund actuary for the OPEB valuation because the firm was familiar with the organization and already had a great deal of applicable data. The Auditor, Chief Administrative Officer, Human Resources Director, Administrator of the County Employee Retirement Association,⁴⁶ and the Board of Supervisors all worked together to establish the valuation's parameters, and to request various scenarios for adjusting retiree health-care subsidies. Because of the significant cost implications, the County was concerned about the assumptions used in the valuation, discussing them in great detail with the actuary. Furthermore, the County wanted to get the "right" assumptions initially so that they would not need changing in subsequent valuations, which could create confusion when comparing the valuations over time.

In addition to the current benefit, the valuation included five other health-benefit scenarios for the purpose of exploring the magnitude of impact on the accrued actuarial OPEB liability from changes in benefits. The Board was clear that these initial scenarios did not represent planned changes to the benefits; rather, they were intended explore what level of benefit-change might be necessary,

and at what speed, to reduce the unfunded OPEB liability and annual retiree health-care costs before those costs could significantly affect the County's ability to fund core services to the public. The County found that grandfathering beneficiaries and applying benefit adjustments to new employees only did not result in significant short-term cost savings.

In order make an immediate change and prevent significant cost escalations, the Board voted unanimously to adopt as a first step the actuarial scenario that had the least fiscal impact on current and future retirees. Under this scenario, the County would pay 85% of the least expensive insurance premium (associated AAL and ARC in Snapshot) for management, confidential employees, and retirees. Until that decision, the County had paid 85% of the premium for all the plans offered. The projected total accrued costs savings equaled \$67.8 million (AAL) and the ARC dropped by \$6.5 million. Under the new benefit plan, the County still retains the burden of paying for increasing medical costs. Furthermore, the County decided to slowly phase in the subsidy adjustment. The County set its maximum contribution equal to 85% of the most expensive plan in 2007. The County will contribute that dollar amount until the least expensive plan premium equals the most expensive plan in 2007. Subsequently, the County would contribute 85% for the least expensive plan premium. The County's goal is to negotiate this benefit level for all active employees through negotiations with Employee Represented Groups. The County continues to maintain that the level of health benefits to retirees is at the discretion of the Board of Supervisors, per California Government Code Section 31691, et seq. If this goal is achieved, the County's AAL will decrease by \$65.8 million to \$315,791,563 and the ARC falls to \$30,685,497.

The Board gave unanimous approval for the new benefit policy even though there was significant opposition from retirees and employees and even though two supervisors were facing reelection. The Board felt that the benefit change was important and the right thing to do. In response, the press and editorials expressed support for the Board's decision.

To address the concerns of labor unions, the Board established a management-labor working group and assigned it a mandate to develop health care savings alternatives. The Board gave the group 6 months to develop recommended solutions. Results are due in the fall of 2007. Using an interest-based bargaining approach, the County hopes that through this process the unions will help craft cost-saving options and a solution to OPEB sustainability, and the County will thereby avoid accusations that these policies have been "forced" upon employees or retirees. The County has three primary interests for the working group: 1) creating a fiscally sustainable health-care benefit; 2) ensuring the benefit plan is fair to all

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 46 The Sonoma County Employee Retirement Association serves as the trustee for the County pension trust

county retirees; and 3) maintaining county services. Though the County is working with unions on health plans that include retirees, the County has reiterated its right to determine retiree benefits and that retirees are not included in labor agreements. Due to the complexity and difficulty of the issue, the process has been slow. However, County senior staff members are encouraged by the attitudes and work of most of the union participants and believe that a reasonable solution can be reached.

In addition to benefit changes, the County must also consider options for meeting its OPEB ARC. For FY 2008, Sonoma will continue with PAYGO for its OPEB liability, but it has set aside \$3 million from the FY 2006 fund balance as one-time seed to address the AAL. The County plans on adding an additional \$4 million before the end of the fiscal year for a total commitment of \$7 million to offset the unfunded AAL.

The initial actuarial report assumes that the County will establish a new trust that will be managed by the Sonoma County Retirement Association. The Retirement Association already manages the County's defined benefit retirement program and retirement trust fund and therefore has the expertise and infrastructure necessary to oversee an OPEB trust. The Association's historical return for its pension investments is 10%, so the 8% discount used in the OPEB actuarial valuation was fairly conservative.

One funding option under serious consideration is issuing OPEB bonds. The County has experience in this arena, having successfully issued pension bonds a few years earlier. The County supports bonds because the bond interest rate will be less than the discount rate and can save the government money over the long term. The County would sell taxable bonds and therefore avoid any arbitrage concerns. The County Auditor felt strongly that issuing bonds would be done only in order to save the government money through interest-rate savings and that the borrowing should not be perceived as an effort to avoid paying OPEB liabilities. Investing the bond proceeds may generate investment earnings of 8 to 10%. However, this is not the primary objective of issuing the bonds. Rather, the County's primary objective is to reduce the interest rate on the AAL.

There are three critical issues that need resolution before the County can issue OPEB bonds. The first concerns reimbursements from the federal government for federally funded programs. Under federal accounting rules, the national government will reimburse state and local governments for program expenditures, including employee salaries and future and current benefits (e.g., pension and OPEB contributions), but will not permit federal money to be directed toward bond repayment. The issue in this case is that by issuing bonds (and repaying them), the County will actually save

the federal government money because less reimbursement will be needed to meet OPEB liabilities due to bond's lower interest rates. The County Auditor was able to receive an exemption to the accounting rule for its pension bonds and is fairly optimistic that the County can receive a similar exemption for OPEB bonds.

The County would also need assurance that a sufficient number of bond buyers were interested in the instrument. As a new investment tool, the County, with perhaps a bond underwriter, would educate investors about characteristics of OPEB bonds, such as their similarity to government pension bonds. This education will inevitably come as more governments issue bonds and the investing community learns about them. The County may also consider issuing an OPEB Certificate of Participation (COP) to raise cash. Because a COP includes a governmental asset as collateral, buyers may feel more secure about debt repayment.

Finally, the County has sought legal advice concerning whether or not an OPEB bond issue implies contractual agreement to provide health benefits for retirees. This same concern exists with creating an irrevocable trust.

A major concern of the Board, County Auditor, and senior management is that the County demonstrates progress in managing OPEB liabilities in order to maintain its bond ratings. As one County official stated, the hammer of GASB 45 and policy changes is the credit rating. The County has an AA rating for its COPs and AAA for General Obligation bonds. The Auditor, based on his discussions with credit-rating companies, believes that the rating companies will expect a county to tell a "good story"; i.e., to demonstrate that the officials are trying to control the underlying drivers of OPEB costs and have a plan for paying OPEB liabilities.

Like several other interviewees in this study, Sonoma's elected officials and staff appreciated the importance of communication in GASB 45 implementation, but found the experience, at times, challenging.

Educating the Board was a smooth process, particularly since the members were knowledgeable about finances due to prior discussions about the County pension and about issuing pension bonds. The Board Chairwoman also took special interest in GASB 45, immediately recognizing that OPEB liabilities could have a seriously negative impact on the County's ability to fund services in the future. The information given to the Board included not only the actuarial report, but also an historical overview of the County's OPEBs, Memorandum of Understandings (MOUs) with unions, legal authority over OPEBs, as well as the short and long-term liabilities. Because of its comprehensive nature, the County used a team for informing the Board that included the County Auditor,

the Chief Administrative Officer, the Human Resources Director and the actuary. Several members of the team also spoke at community meetings.

Due to union sensitivity over County communication with employees regarding issues which are negotiated in labor contracts (i.e., compensation) and the desire to reach all stakeholders quickly, the County relied on union representatives and officers of the retirement association to discuss GASB 45 with their members. Though the goal was to reach all retirees and employees about GASB 45 and proposed changes in retiree health-benefits, that, unfortunately, did not occur. County staff now realize they should have spoken directly with employees and retirees, rather than relying on persons outside the County organization to deliver what was perceived to be “bad news.”

The County held public hearings to discuss the proposed retiree-benefit amendments (explained above). These were contentious. In the words of one Board member, “GASB 45 is the thorniest issue we’ve had to deal with in many years.” Because information about the proposed adjustment was not fully relayed, many retirees heard incorrect information or did not understand the impact the proposal would have on them. Some jumped to very negative conclusions, such as they were losing access to the County health plan. Officials then had to spend time clarifying the situation, explaining that retirees would always have access to the County health plan, but that the level of subsidy might differ in the future.

Though they might not personally benefit, Sonoma residents care about how the County treats its employees and retirees. Sonoma is the largest employer in the county, and everybody knows someone who works for the government. Because of this community interest, the Board and management were concerned about the public’s reaction to GASB 45; however, they found that the public was not particularly sympathetic to complaints about the minor benefit adjustment because most residents do not receive similar compensation from private employers.

In order to prevent misunderstandings, the County plans to communicate directly with employees in the future. Direct communication has been sent to all employees and retirees, a website has been developed, and input is being received and responded to by a subcommittee of staff and union officials on OPEB. Senior management did meet with department directors, explaining GASB 45 implementation so that they could, in turn, speak with their employees. However, the results were mixed because all the directors needed to fully understand GASB 45 and support management’s decision for this communication path to be successful.

County staff believe they need to underscore the differences between employee and retiree benefits when discussing GASB 45 implementation in the future. More specifically, beneficiaries need to understand that the two are not linked and that the County can amend OPEBs while still complying with labor agreements. Some staff are concerned that stakeholders may sue the government over amending retiree-health benefits, but they are confident the County will win any legal challenge.

In sum, though Sonoma has already made some difficult choices in controlling OPEB liabilities, officials believe more will need to be done to ensure retiree benefits are sustainable over the long term. Doing so is likely to include both the County and retirees giving a little more, making the latter’s engagement in finding and agreeing to a solution all the more important.

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Carl Vinson Institute of Government
University of Georgia

